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BREAKING THE RULES:

**AT&T'S ATTEMPT TO BUY A NATIONAL MONOPOLY IN CABLE
TV AND BROADBAND INTERNET SERVICES**

August 17, 1999

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BREAKING THE RULES:
AT&T'S ATTEMPT TO BUY A NATIONAL MONOPOLY IN CABLE TV
AND BROADBAND INTERNET SERVICES

EXECUTIVE SUMMARY

This paper analyzes the horizontal and vertical domination that AT&T is seeking to exert over the cable TV and broadband Internet markets through its acquisition of MediaOne and related deals with Microsoft and Cox.

- The proposed deal breaks every Federal rule designed to protect consumers from the abusive concentration of ownership in the 1990s.¹

A. THE IMPACT OF THE MERGER AND RELATED DEALS

The AT&T-MediaOne merger and related deals have a pervasive impact across several markets (See Exhibit ES-1). The deals result in dramatic increases in concentration in horizontal markets including:

- cable distribution (to the extent that cable companies do or can compete in local, regional and national markets); cable programming (to the extent that programs compete to increase viewership); and broadband Internet services (to the extent that @Home and RoadRunner can and do compete).

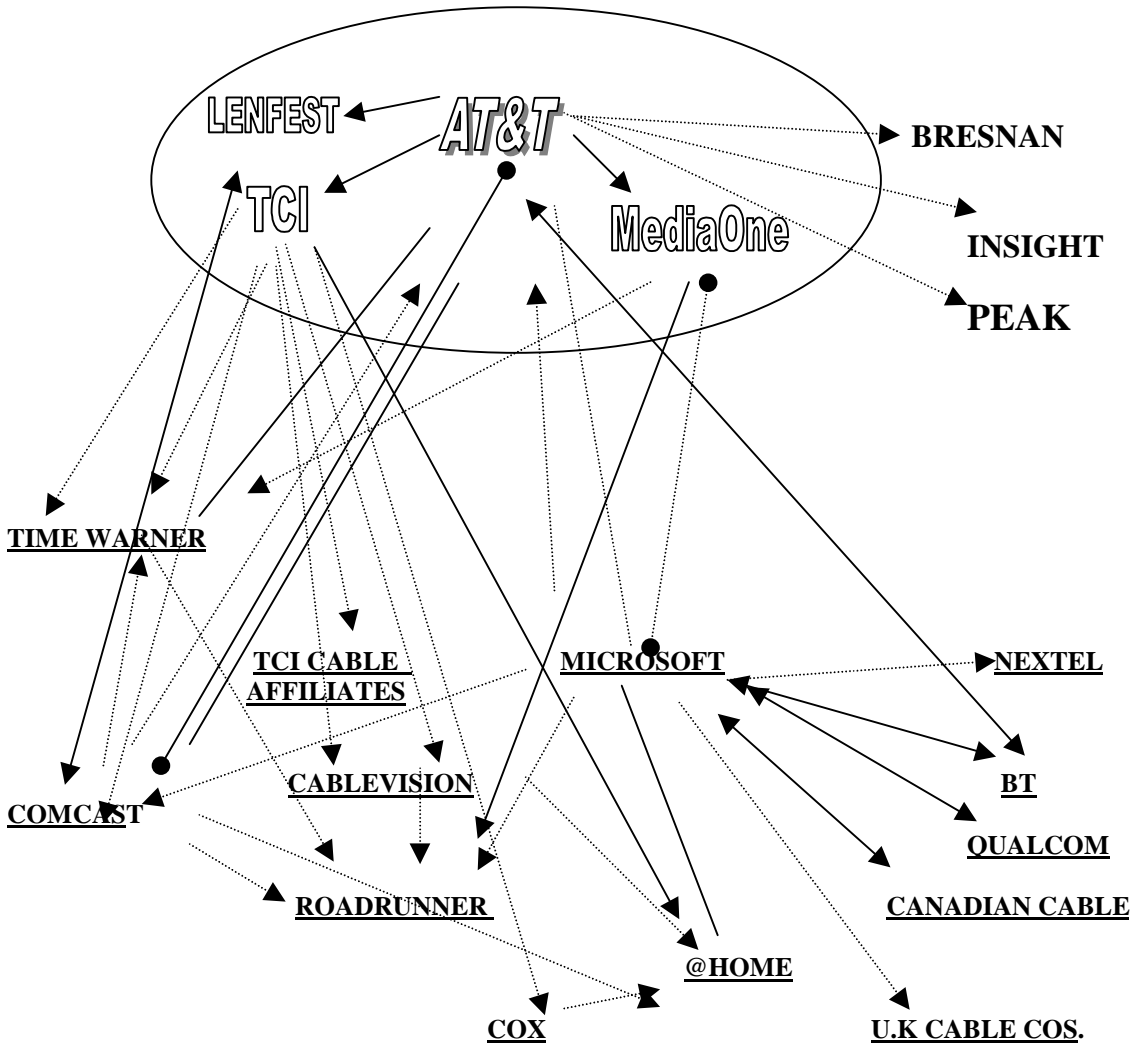
The deals pose severe problems of vertical integration between programming and distribution.

- In cable, MediaOne/Time Warner are integrated with the previously acquired TCI distribution system.
- In broadband Internet services they integrate the @Home and RoadRunner programming services with a much larger distribution network and integrate distribution and equipment (the design and operation of the set top box by programming and distribution entities) by giving Microsoft preferred access.

The deals have elements of conglomeration of geographic and product markets.

¹ These include the Horizontal ownership limits implemented by the Federal Communications Commission (FCC) under the 1992 Cable Act and the Merger Guidelines adopted by the Department of Justice (DOJ) under the Sherman and Clayton Acts.

**EXHIBIT ES-1
 AT&T'S DIGITAL CONGLOMERATE
 AT THE HEART OF A BROADBAND CARTEL
 (AS ANNOUNCED)**



LEGEND:
STOCK OWNERSHIP: MAJORITY ———▶ ; MINORITY▶
JOINT VENTURE: ◀————▶
USE DEAL: EXCLUSIVE ———▶ ; PREFERRED▶
SWEETENERS: ●.....●

- To the extent that distribution is considered a local market, the merger constitutes market-extension, since much greater geographic dominance is achieved.
- To the extent that the purpose of the merger is to utilize the broadband network to distribute cable, Internet and telephone service, it constitutes product-extension, with the power to dominate this new market.

B. BREAKING THE RULES ON CONCENTRATION OF OWNERSHIP

To summarize the horizontal concentration problem briefly, the Merger Guidelines state that the Department of Justice is likely to challenge mergers in moderately and highly concentrated markets that raise the level of concentrations (as measured by the Hirschman Herfindahl Index (HHI)) by 50 to 100 points. All of the markets that involve cable

**EXIHIBIT ES-2:
THE AT&T/MEDIAONE AND RELATED DEALS EXCEED THE LIMITS
ON CONCENTRATION OF OWNERSHIP (AS FILED)**

	LEGAL LIMIT	AT&T MEDIAONE IMPACT
FCC HORIZONTAL OWNERSHIP (% OF HOMES PASSED)		
CABLE	30	57
DOJ MERGER GUIDELINES (HHI INCREASE)		
CABLE		
DISTRIBUTION	50	1042
PROGRAMMING	50	1173
INTERNET		
CABLE-BASED BROADBAND		
DISTRIBUTION	50	2970
SERVICE	50	3596
CABLE-BASED BROADBAND +TELCO WIDEBAND		
DISTRIBUTION	100	700
SERVICE	50	2064

distribution, cable programming, broadband Internet distribution and broadband Internet programming would be moderately to highly concentrated as a result of the deals.

- The merger raises concentration in each of these markets by between 700 and 3,000 points.

Similarly, it fractures the FCC's limits on horizontal ownership.

- Under the FCC ownership attribution rules, AT&T would have about 55 million homes passed which would give it just over 57 percent of the Multichannel Video Programming Distribution market. Given that the FCC has adopted a limit of 30 percent, AT&T is well past the horizontal limit.
- AT&T will have just under 35 million subscribers. This would give it almost 50 percent of the cable TV market.

The horizontal concentration in these markets rises to a level that is unprecedented in the industry. This creates a unique and new barrier to entry to compete against AT&T's cable business, leaving consumers paying inflated prices even when there is some "choice" in the market.

- AT&T could use its vast footprint and leverage its market power to retaliate against an established cable, satellite or telephone company that sought entry into its region.
- As an excessively large programming purchaser, AT&T could exercise market power by raising prices or otherwise driving up costs.

The market concentration problem in the realm of broadband Internet service parallels the cable industry problem. The cable distribution plant is the dominant form of broadband Internet service. Even when developing telephone alternatives like Digital Subscriber Line (DSL) are accounted for, AT&T's broadband distribution system will dominate the market with the power to raise prices and costs to competitors.

The deals have a dramatic impact on programming concentration. The incentive and ability to frustrate competitive entry through leveraging of programming is quite clear.

- The cable companies involved in the AT&T deals are the dominant players by far. The merger raises the national concentration in cable programming by well over 1,000 points.
- The only two widely available Broadband Internet programming services – @Home and RoadRunner – are joined in the AT&T/MediaOne merger. The cable-based broadband Internet market is currently highly concentrated. The merger would increase the market share by 3000 points. If the analysis were done on actual customers, it would reveal an even more dramatic impact on the cable-based broadband Internet market.

Even if telephone wires and the current base of DSL customers are included, the merger fails to pass muster in the high speed Internet entertainment market.

- The market remains moderately concentrated in distribution and the merger increases concentration by much more than the Merger Guideline limit.
- In high speed Internet services the market remains highly concentrated and the merger adds over 2,000 points to the HHI.

C. THE ANTICOMPETITIVE EFFECTS OF EXTREME VERTICAL INTEGRATION

Although vertical mergers are less likely to be challenged as a general proposition, the AT&T-MediaOne merger and related deals present unique and troubling characteristics. Large dominant players in different markets are integrating through an acquisition strategy, not an expansion strategy.

- In addition to the direct ownership and control of vertically integrated activities, AT&T is using a variety of other means – contracts, leasing, etc. – to ensure vertical dominance.
- The size and market reach of the firm raises questions about barriers to entry caused by the need for others to simultaneously enter multiple market.
- The closed access policy being extended by AT&T from the cable TV industry to the broadband Internet industry creates problems of price squeeze and quality discrimination. The network is being designed technologically, implemented contractually and managed operationally in a way that discriminates against unaffiliated service providers and precludes certain forms of commerce.
- As part of the transaction, AT&T has entered into a series of exclusive and preferential deals for the use of facilities and products. Given the size of the parties and the nature of the market, this head start will provide an insurmountable advantage to dominant firms.

D. AT&T'S ATTEMPT TO HIDE THE PROBLEM

To obscure these critical problems in its application for license transfers at the Federal Communications Commission, AT&T establishes a series of diversions to deflect attention away from the fundamental market power issues raised by the merger and its related deals.

AT&T has proposed a series of minor spin-offs and restructured ownership. These do not get to the core of the market concentration or vertical integration problems.

AT&T claims to have voluntarily renounced its property rights by setting up Liberty Media as a tracking stock and Time Warner with a management committee. These “trust-me” firewalls are merely band-aids that do not solve the conflict of interest problem.

- There is no better proof that these gimmicks cannot be relied on than to recall that Liberty, the purportedly independent programming subsidiary within the holding company, has been spun off from TCI and pulled back so many times its corporate logo should be a yo-yo.

AT&T defines markets in overly broad terms. For example, AT&T argues that narrowband and broadband Internet services are in one market even though broadband is 100 times faster.

- This is like claiming that the pony express and Federal Express are comparable forms of mail delivery.

AT&T wants federal authorities to assume that future performance of competing technologies will prevent the abuse of market power, even though these very same technologies have failed to prevent the abuse of market power in the cable industry since it was largely deregulated in 1984.

- Wireless has never been able to discipline the pricing abuse of cable and its limitations for broadband Internet are even more severe.
- Digital Subscriber Line does not afford the speed of cable modems, is restricted in the number of households it can pass, is far behind in deployment and subscribers, and is likely to be a business-oriented, not a residential, service.
- AT&T has failed to compete using the very same technologies. Competitors now face the added problem of a massive, integrated company that must be overcome.

AT&T promises to finally deliver local telephone competition.

- As a general principle, trading massive increases in market power in one industry for a potential reduction in market power in another industry is bad public policy.
- As a practical matter, it is clear that the competition AT&T might bring to the local telephone market would not overcome the damage it would do to the cable TV and broadband Internet markets.

E. CONCLUSION

Consumers hope that technological breakthroughs will finally undermine the market power of the cable companies and prevent it from spreading to broadband Internet service, but

merger and market power analysis cannot be based on hope or hype. Federal authorities must deal with the reality of markets.

- The AT&T deals are not a case of a close call that can be mitigated by small changes; this is a massive increase in concentration.
- The rules and guidelines that the merger violates are not “antiquated” relics of some past industrial age; all were adopted within the last decade by policymakers keenly aware of the structural rules necessary to promote competition.

AT&T is seeking exceptions from the rules in industries that are not immune to anticompetitive abuse.

- The primary industry in which the rules and guidelines are being violated – cable TV – was just last year called by the Department of Justice one of the nation's “most durable and powerful monopolies.”
- The other industry in which the merger would have its anticompetitive impact (broadband Internet services) involves an industry and another company (Microsoft) that have already raised concerns at the Department of Justice.

Just two years ago the Federal Trade Commission (FTC) found that the relevant cable markets were concentrated, entry was difficult, and a previous merger involving Time Warner/Turner/TCI created the incentive and ability to lessen competition and increase prices to consumers. It rejected preferential deals for TCI (now owned by AT&T) and required reduction of TCI ownership in major interconnected firms to non-attributable, passive levels.

Federal authorities should be even more alarmed by the AT&T/MediaOne merger and related deals.

- The cable industry has become more highly concentrated and pricing abuses continue.
- The broadband Internet market is in an even more vulnerable condition.
- AT&T has added a thick layer of vertical domination atop horizontally concentrated markets.
- Given the web of cross ownership, joint ventures, and exclusive or preferential deals, the likelihood that any of the companies interconnected in the digital cartel will vigorously compete against the other companies in the cartel is slim.

I. PUBLIC POLICY CONCERNS ABOUT MARKET POWER IN THE CABLE TV AND BROADBAND INTERNET BUSINESS

This paper analyzes the horizontal and vertical domination that AT&T is seeking to exert over the cable TV and broadband Internet markets through its acquisition of MediaOne and related deals with Microsoft and Cox. The report is organized as follows.

Chapter I presents an introduction to the public policy issues involved and a brief overview of the findings and conclusions.

Chapter II presents a general framework for analysis and an overview of the many markets and market dimensions that are affected by the merger. It provides definitions and concepts and makes no direct reference to the specific merger. Those familiar with the industrial organization branch of economics or who cannot abide economic theory need not tarry here, as all of the empirical analysis is presented in chapters III and IV.

Chapter III presents a discussion of the horizontal concentration and vertical integration resulting.

A. COMMUNICATIONS ACT CONCERNS

1. CONCERNS ABOUT ECONOMIC CONCENTRATION IN THE CABLE TV INDUSTRY

Soon after AT&T announced its acquisition of MediaOne,² which itself came less than a year after the purchase of cable giant TCI, it discovered that federal rules on ownership of

² Graphic headlines give the context for the flap that the MediaOne acquisition set off (see, for example, Fahri, Paul, "AT&T: Too Big Once Again?," *Washington Post*, April 27, 1999, "AT&T Poised to Regain it Long Reach, Via Cable," *Washington Post*, May 6, 1999; Bank, David, "As World Collide, AT&T Grabs a Power Seat," *Wall Street Journal*, May 6, 1999, Quinton, Brian, "Stealing Home," *Telephony*, June 14, 1999 (hereafter, *Stealing Home*);

cable systems might pose a problem.³ These rules, which were mandated by the 1992 Cable TV Act,⁴ are intended to curb excessive market power in the ownership of cable distribution systems. The rules establish a framework for counting the number of subscribers a cable company owns/controls.⁵ The rules attribute control of subscribers based on the ownership of a specific percentage of active (5% voting) and passive (10% non-voting) shares of stock.⁶ They then establish an upper limit on the percentage of the national market that any one company can control.⁷

FCC's suspended attribution rules define a mere 5% ownership of voting stock as sufficient for company to have "cognizable interest" under Sec. 613(f) of the Communications Act passed as part of 1992 Cable Act. For passive investments, only 10% interest is necessary. In adopting both these attribution rules and the 30% limit, FCC argued that limits were necessary to prevent any single MSO from having undue influence over programming access. Startup cable networks say they need access to at least 20 million homes to be viable, and fear that they could be blocked by MSO with cable control over too many homes. Owning 5% of MSO may entitle shareholder to seat on board, for example, providing substantial influence, Commission has said.⁸

³ "AT&T Household Reach to be Issue in MediaOne Merger Review," *Communications Daily*, May 10, 1999 (hereafter, Household Reach).

⁴ *Cable Television Consumer Protection Act of 1992*,

⁵ *Notice of Proposed Rulemaking, In the Matter of Implementation of the Cable Television Consumer Protection Act of 1992 – Review of Commission Cable Attribution Rules*, 13 FCC Rcd. 12990 (1998).

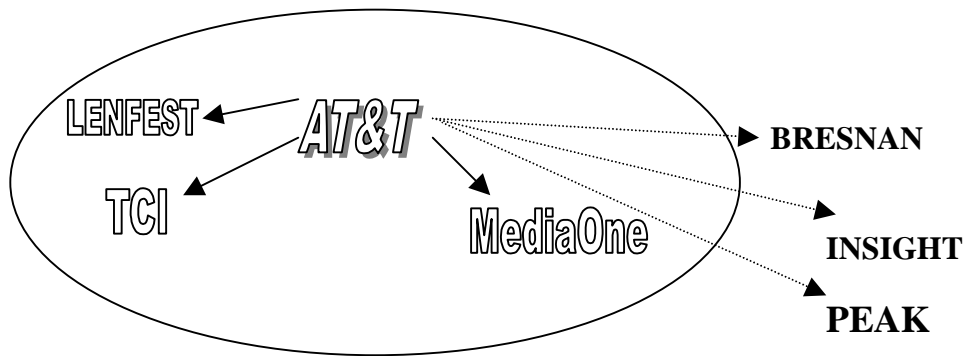
⁶ Federal Communications Commission, *In The Matter of Annual Assessment of the Status of Competition in Markets for the Delivery of Video Programming*, CC Docket No. 98-102, December 17, 1998, used these rules to describe the market structure of the cable and multichannel video program distribution (MVPD).

⁷ *In the Matter of Implementation of Section 11(c) of Cable Television Consumer Protection and Competition Act of 1992 – Horizontal Ownership Limits*, MM Docket NO. 92-264.

⁸ Household Reach, the style shortened style appears in the original publication .

Although the Federal Communications Commission (FCC) voluntarily stayed the rules, the FCC is in the process of vigorously defending them in court and is currently considering making minor modifications to them. In order to avoid running afoul of these rules, AT&T attempted to present itself as a large, but not too large, cable system owner. To present this picture, AT&T's ownership interest must take into account only large holdings in cables systems as depicted in Exhibit 1.

EXHIBIT 1
AT&T'S SELF-PROTRAIT AS A 'NOT TOO BIG' CABLE COMPANY



AT&T chairman-CEO Michael Armstrong for 2 weeks has reassured financial analysts that merged AT&T-MediaOne Group wouldn't encounter significant regulatory hurdles. On May 5 he told analysts AT&T would pass only 35% of U.S. homes after deal "if the old [horizontal ownership] rules did come back, which we don't think they will."⁹

Under the FCC's rules, however, AT&T's market share is a concern. The ownership of cable interests that it portrays, as summarized in Exhibit 1 would give it between 23 and 35

⁹ Household Reach.

percent of the cable TV market.¹⁰ Even at this level, the merger could be challenged.

However, with the attribution rules operative, AT&T is much larger and the merger would have a serious problem passing muster. Moreover, AT&T could be said to pass about 2/3 of homes through combination of those wholly owned systems and systems in which it would have a stake, such as Cablevision Systems (via former TCI) and Time Warner Entertainment (ex-MediaOne partnership).¹¹

In an effort to convince Wall Street that regulatory approval of the merger would be easy, not only did AT&T paint a picture of a somewhat large, but not too large cable company, it assured investors that it had been talking to the FCC about the issue.

As for suggestions that AT&T has told investors it's talking with Commission when in fact it is not, Cicconi said "we absolutely have had conversations with a number of people over there [at FCC], including today."¹²

AT&T's general counsel also launched an attack on the federal rules that limit the market share any single cable company could own.

When confronted with this analysis however, AT&T General Counsel James Cicconi said: "These inflated figures... are absurd on [their] face."

Cicconi in conference call Fri. faulted "absurd" attribution rules from FCC... Told that FCC Cable Bureau might find AT&T passed 2/3 of homes under attribution rules, he said, "that's absolutely not the right figure. Cicconi said AT&T doesn't feel Cablevision and Time Warner ownership should count."¹³

¹⁰ "A Win-Win for Comcast, AT&T," *Broadband*, May 6, 1999 (hereafter Win-Win), attributes to AT&T Chairman Michael Armstrong and estimate "of 23% – 35% (depending on how the FCC ultimately defines cable ownership) of the nationwide cable homes passed,"

¹¹ Household Reach.

¹² Household Reach.

¹³ Household Reach.

AT&T's problem, however, was bigger than a near miss on the horizontal ownership limits. After testing the waters in Washington, AT&T found that there are some policymakers who not only take the horizontal ownership limitations seriously, but also consider vertical integration of programming and control over broadband Internet access using cable modems to be important public policy issues.¹⁴ Policymakers,¹⁵ competitors,¹⁶ and public interest groups¹⁷ expressed concerns and congressional hearings were held.¹⁸

If AT&T could not simply steam roll through the regulatory review process, the entire corporate structure that it had constructed as part of its foray into the cable industry would be closely scrutinized.¹⁹ The actual structure of vertical and horizontal ownership and control that AT&T had amassed was quite different than the simple, self-effacing self-portrait AT&T was painting.

¹⁴ Cleland, Scott C. and Patrick Brogan, "The Regulatory Landscape on Cable Equal Access," *Legg Mason Precursor Research*, May 18, 1999; "Not So Fast, AT&T: DC Reminds Dealmakers of Its Relevance in Setting Approvals," *Phillips Publishing International*, May 11, 1999; Borland, John, "Broadband Cable Access Issue Reaching Congress," *CNET News. Com*, July 6, 1999.

¹⁵ The TCI merger had already stimulated concerns, see for example, the hearing before the Communications Subcommittee, Senate Committee on Commerce, Science and Transportation, April 13, 1999; Schiesel, Seth, "Concerns Raised as AT&T Pursues New Foothold," *New York Times*, May 6, 1999; McConnell, Bill, "Washington to Scrutinize Merger," *Broadcasting & Cable*, May 10, 1999.

¹⁶ Seminerio, Maria, "Group Demands Open Access to Cable Lines," *ZDNet: PCWeek OnLine*, February 4, 1999.

¹⁷ *Letter to Chairman Bill Kennard from Center for Media Education, Computer Professionals for Social Responsibility, Consumer Federation of America, Consumers Union, Media Access Project*, January 27, 1999, requesting an expedited hearing on open access.

¹⁸ "AOL, Cable Execs, Sprint Square Off over Broadband Access," *CNNfn*, June 24, 1999.

¹⁹ "FCC to Scrutinize AT&T, MediaOne Deal," *Broadband*, May 10, 1999.

Exhibit 2 depicts the various ownership, joint-venture, and leasing arrangements that constitute what can rightly be called a digital, communications cartel. Not only do the number of cable subscribers that are attributable to AT&T skyrocket once the attribution rules are invoked, but AT&T's ownership of programming and Internet services, as well as its equipment deals come into view. Once the concentration of excessive economic power behind this merger is recognized and questioned, AT&T faces a problem.

Recognizing that the scrutiny would be far more probing than it had hoped, AT&T began to restructure its presence in the cable TV industry with respect to some of its more prominent holdings.²⁰ By all accounts, it still intends to keep its Cablevision and Time Warner interests, as well as its broadband Internet ventures. AT&T appears to be trying to come close enough to horizontal guidelines to get a waiver, if it could not come into actual full compliance with the rules.²¹ These actions might alleviate the pressure on the vertical aspects of the merger and related deals and make a waiver more likely.

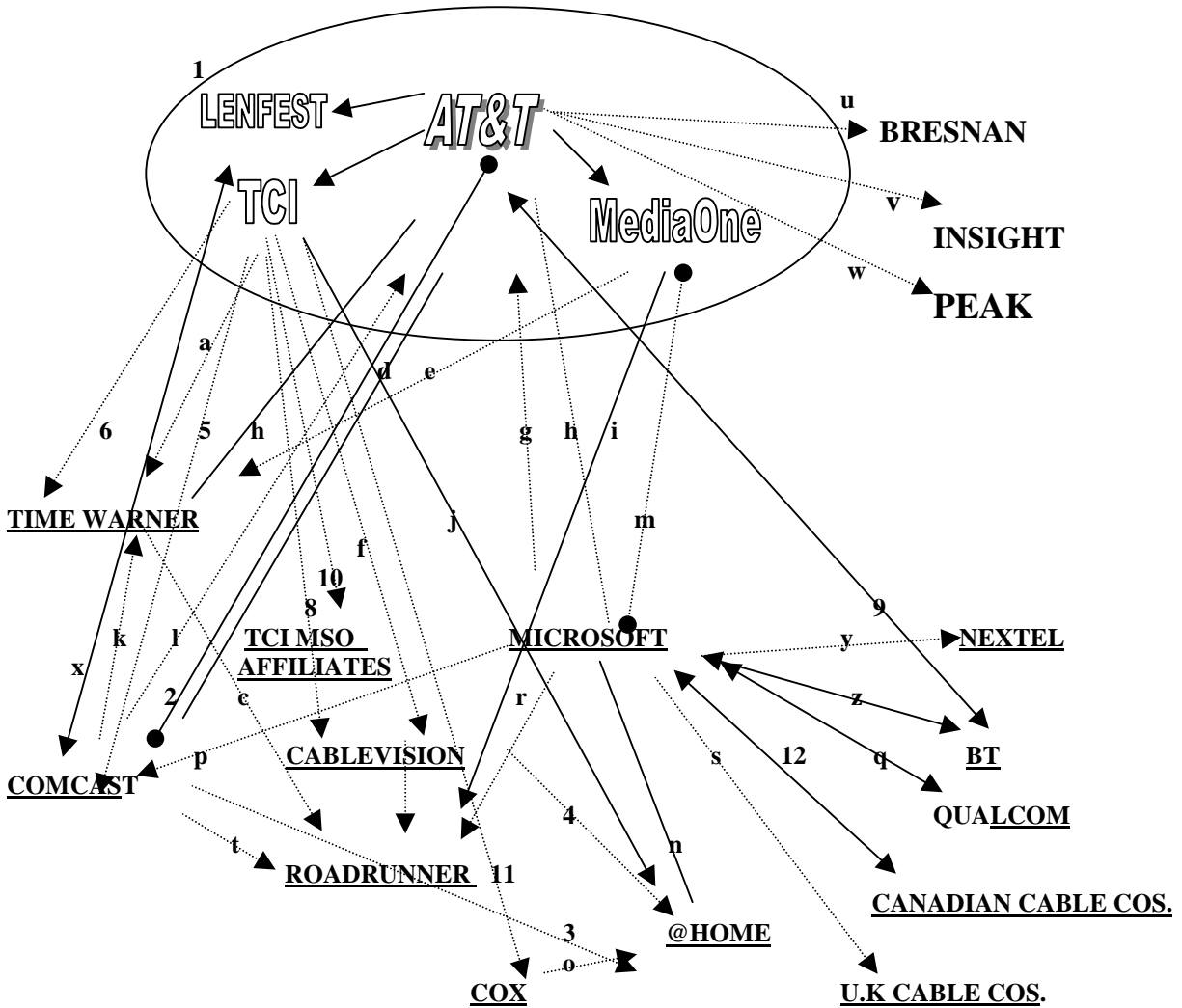
²⁰ Higgins, John, M., "AT&T's Incredible Shrinking Plan," *Broadcasting & Cable*, May 31, 1999; Cho, John, "AT&T Seeks to Dissolve Most JV Thru Swaps," *Cable World*, June 28, 1999.

²¹ Win-Win, presents the following discussion, including Armstrong's suggestion that the cap should be raised

Although the FCC rules, currently suspended pending an upcoming rewrite, cap cable system ownership at 30% of all national homes passed, some cable lawyers think it is likely the new rules will raise the cap to 35%, potentially allowing AT&T to squeak under that limit with the Comcast adjustments.

Even if AT&T slips above the cap, the company will comport itself to fit the regulatory rules, Armstrong said. Still Armstrong made his case on why the rules need to be changed. First, "with the whole world going digital and the need to compete with local telcos," he argued, the cap should be raised. The homes passed component, he argued, should be changed to take into account the multiple competitors, such as direct broadcast satellite and streaming Internet video, that now reach any given home.

**EXHIBIT 2
AT&T'S DIGITAL CONGLOMERATE
AT THE HEART OF A BROADBAND CARTEL**



LEGEND:
STOCK OWNERSHIP: MAJORITY ———▶ ; MINORITY - - - - -▶
JOINT VENTURE: ◄————▶
USE DEAL: EXCLUSIVE ——— ; PREFERRED - - - - -
SWEETENERS: ● - - - - - ●

DESCRIPTIONS OF RELATIONSHIPS AND IDENTIFICATION OF SOURCES:

- 1 = wholly owned subsidiaries (2)
- 2 = \$1.5 billion breakup fee (10)
- 3 = large minority (12); 12% (16)
- 4 = (6)
- 5= QVC Joint venture (16)
- 6 = Programming joint venture through Liberty (22); 10% (16)
- 7 = Wholly owned (16)
- 8 = Programming joint venture through Liberty (22); Investment (19)
- 9 = (20)
- 10 = TCI MSO Joint ventures (4)
- 11 = Programming joint venture through Liberty (22)
- 12 = Set top box joint venture (15)

- a = 10% Ownership of Time Warner (23)
- b = exclusive deal for telephony (6)
- c =25% (6)
- d = exclusive deal for telephony (5)
- e = 26% (1)
- f = 25% (1) (4)
- g = 3% ownership (3) (5)
- h = up to ten million set tops guaranteed (3)
- i = Majority (5); 25% (6)
- j = 39% (6)
- k = 25% (6)
- l = exchange of systems is likely to be consummated with a stock swap (2)
- m = Microsoft gets to buy MediaOne's European cable systems (9)
- n = Windows NT in @Home solutions network (13)
- o= Minority (6)
- p = 11% ownership (5) (12)(17)
- q = wireless Internet (8)
- r = Through Comcast (5)(12); Direct (18); 10% (16) (20)
- s = 5% NTL, 30% Telewest, 30% Cable&wireless (14)
- t = Minority (5)(12)
- u = 49% (1)
- v = 34% via MediaOne (1)
- w = Majority (1)
- x = Manager of AT&T owned systems (7) (11)
- y = 4% (8)
- z = wireless Internet (8)

SOURCES:

- (1) "AT&T Household Reach to be Issue in MediaOne Merger Review," Communications Daily, May 10, 1999.
- (2) "War Ends: AT&T and Comcast Cozy up in Solomon-Like Deal," Broadband Daily, May 5, 1999.
- (3) "AT&T Comes Out on Top in Microsoft Deal," Broadband Daily, May 10, 1999.
- (4) "FCC to Scrutinize AT&T MediaOne Deal," Broadband Daily, May 10, 1999.
- (5) "AT&T Poised to Regain Long Reach, Via Cable," Washington Post, May 5, 1999.
- (6) "AT&T Goes Cable Crazy," Fortune, May 24, 1999.
- (7) "AT&T Chief's \$120 Billion Plan Capped by Deal for MediaOne," Washington Post, May 6, 1999.
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- (17) Fabrikant, Geraldine and Seth Schiesel, "AT&T Is Seen Forging Link to Microsoft," New York Times, May 6, 1999.
- (18) Markoff, John, "Microsoft Hunts Its Whale, the Digital Set-Top Box," New York Times, May 10, 1999.
- (19) "ACTV Gets Boost from Liberty Digital," Broadband Daily, May 17, 1999.
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- (21) Fabrikant, Geraldine and Laura M Holson, "Key to Deal for MediaOne: Keeping the Losing Bidder Happy," New York Times, May 6, 1999.
- (22) Federal Communications Commission, In the Matter of Annual Assessment of the Status of Competition in Markets for the Delivery of Video Programming, CC Docket No. 98-102, Fifth Report, Table D-6.
- (23) Federal Communications Commission, In the Matter of Annual Assessment of the Status of Competition in Markets for the Delivery of Video Programming, CC Docket No. 98-102, Fifth Report, Table D-1.

B. CONCERNS ABOUT BROADBAND INTERNET ACCESS

AT&T's problems at the federal level are not its only difficulties. Within months of the announcement of the MediaOne deal, AT&T lost a ruling related to its prior acquisition of TCI.²² A Federal District Court judge had ruled that the City of Portland, as the franchising authority for cable services, had the right to order the former TCI franchise, now owned by AT&T, to provide nondiscriminatory access to broadband Internet services.

The initial experience in Washington did not change AT&T's attitude about its duty to comply with this country's laws. AT&T insists that its legal right to sign an exclusive contract with an Internet service provider takes precedence over the right of the franchising authority to impose an open access requirement. It has threatened not to deploy the service.

AT&T says the ruling is a catch-22 because the company's contract with @Home grants @Home exclusive distribution rights on AT&T's cable network.

"They have put in place an ordinance we cannot comply with legally or technically," says John Cicconi, AT&T's general counsel. "It is not a condition with which we can comply and still deploy the @Home offer. The real losers in this decision, until it is overturned, are the people of Portland."

In response to AT&T's vow to withhold @Home, Portland officials are considering opening the city's nonexclusive franchise to a second operator.²³

AT&T again attacked the intelligence of the ruling.

²² *AT&T; Tele-Communications, Inc.; TCI Cablevision of Oregon, Inc., and TCI of Southern Washington v. City of Portland and Multnomah County*, In the United States District Court for the District of Oregon, CV 99-65-PA, June 3, 1999

²³ Colman, Price and Bill McConnell, "AT&T's Got the Unbundling Blues," *Broadcasting & Cable*, June 14, 1999 (hereafter, Unbundling Blues).

Cicconi is confident AT&T will win on appeal, though he acknowledges Panner's ruling was a surprise. "Did we expect this? No," he says. "In a case you don't even consider to be close on the law, you don't expect the court to reach such a result."²⁴

Similar disputes relating to the transfer of TCI licenses bubbled up in cities across the country.²⁵ Broward County, Florida voted for open access.²⁶ A technology commission in Los Angeles experienced the resignation of three of its members (thereby losing its quorum) in protest over a report that argued against imposing open access on cable broadband Internet services.²⁷ Similar disputes arose in San Francisco, where the City Council rejected a staff report that failed to recommend open access²⁸ and later voted to declare a general commitment to open access and to join in the Portland suit, but did not adopt specific open access requirements.²⁹ Counties weighed in on the side of open access.³⁰ Washington

²⁴ Unbundling Blues.

²⁵ Quinton, Brian, "Cities Prep for AT&T Siege," *Telephony*, June 28, 1999

²⁶ Chen, Kathy, "Another Local Government Votes to Open Cable Lines to Competition," *Wall Street Journal*, July 14, 1999.

²⁷ Guy, Sandra, "Cities March Noisily Into Internet Access Battle," *Techseeb*, June 22, 1999; Mullen, Alex, "Broadband Access Battle Erupts," *ZDTV*, July 8, 1999; Grice, Corey, "Cities Take Open Access Fight to the FCC," *CNET News*, June 21, 1999.

²⁸ Solomon, Deborah, "S.F. Board President Opposes AT&T Cable Plan," *San Francisco Chronicle*, June 24, 1999.

²⁹ Healy, Jon, "AT&T Wins S.F. Vote on Access," *Mercury News*, July 28, 1999.

³⁰ Seminerio, Maria, "counties Call for Open Access," *ZDNet*, July 20, 1999.

policymakers were not inactive in the broadband issue, with hearings³¹ and legislation introduced on all sides of the issue.³²

AT&T's acquisition of MediaOne's broadband services also raises another set of concerns because it includes a deal with Microsoft to supply a very large part of the initial orders for set-top boxes to deliver broadband services. As part of the final deal Microsoft will be allowed to deploy between 7.5 and 10 million of the first set-top boxes.³³

Microsoft is currently embroiled in the most celebrated antitrust case in several decades (since the breakup of AT&T). The case alleges that Microsoft had engaged in a variety of anticompetitive practices to defend its monopoly control over the operating system for PCs and extend it to web browsers. Microsoft's deal with AT&T gives it the inside track in providing the operating system for broadband set-top boxes. This agreement immediately drew analogies between the interactive broadband market and the PC market.

The laggards feared that they would inevitably fall victim to the same forces that enabled Microsoft to reduce many PC hardware makers to mere purveyors of commodity goods.

But Microsoft's considerable financial heft has eroded most resistance. Besides the Comcast stake, Mr. Gates' investments in pursuit of interactive digital TV have included WebTV, Time Warner's Road Runner, four European interactive cable television investments and, finally, last week's investment in AT&T.

³¹ Woods, Bob, "AOL, Cable Execs, Sprint, Square Off Over Broadband Access," *CNNfn*, June 24, 1999; Cable Honchos Fumble Senate Appearance," *The Industry Standards*, July 15, 1999.

³² Rick Boucher, "Internet Growth and Development Act of 1999; Bob Goodlatte, Internet Freedom Act; Billy Tauzin and John Dingell, "The Internet Freedom and Broadband Deployment Act of 1999; Ed Markey, "Concurrent Resolution;" Earl Blumenauer, "Consumer and Community Choice Access Act.

³³ Austria, Melanie, "Microsoft, AT&T in \$5 Billion Pact," *CENT News.Com*, May 6, 1999.

In return for a \$5 billion stake, AT&T has warily agreed to license a minimum of five million copies of Microsoft's Windows CE operating system and engage in several showcase tryouts of the software, the consumer electronics version of Microsoft's industry-dominating Windows software for PCs.

The deal will ensure that Microsoft gets an inside track in the new interactive television industry, which after years of delay appears to be showing signs of life.³⁴

Although the deal was preferential, not exclusive,³⁵ the union of two giant firms with a history of market domination could not go unnoticed. In fact, after securing preferential access to as many as 10 million of AT&T broadband cable subscribers, Microsoft inked another deal with @Home, a subsidiary of AT&T, to extend its reach even further by capturing part of the server side of the market.³⁶ It quickly signed similar deals with other cable companies to provide software and acquired interests in other cable companies, increasing its early advantage.³⁷

C. ANTITRUST PROBLEMS

1. HORIZONTAL CONCENTRATION

Although the public policy debates with FCC regulators and local officials have received the greatest attention, the AT&T-MediaOne merger also has problems over at the Department of

³⁴ Markoff, John, "Microsoft Hunts Its Whale, the Digital Set-Top Box," *New York Times*, May 10, 1999.

³⁵ "AT&T Comes Out on Top in Microsoft Deal," *Broadband*, May 7, 1999.

³⁶ Broersma, Matthew, "Microsoft, @Home Make Broadband Pact," *ZDNET*, May 13, 1999;

³⁷ Bank, David, "Microsoft to Invest \$600 Million in Nextel," *Wall Street Journal*, May 11, 1999; Cowell, Alan, "A Contest is On In Britain to Revolutionize Cable TV," *New York Times*, May 13, 1999; *Broadband Daily*, *Microsoft's Broadband Investments Total \$11 Billion*, June 11, 1999; Bruznick, Alan, "Microsoft Sinks \$30 Million into Wink," *Cable World*, June 14, 1999;

Justice. Merger Guidelines issued in 1992 established standards under which mergers are likely to be challenged³⁸ These guidelines, originally written early in the Reagan administration, establish what are, by historical standards, fairly lenient standards for mergers. Yet, as shown in Exhibit 3, in every media market affected by the merger, the Guidelines are violated by a wide margin.

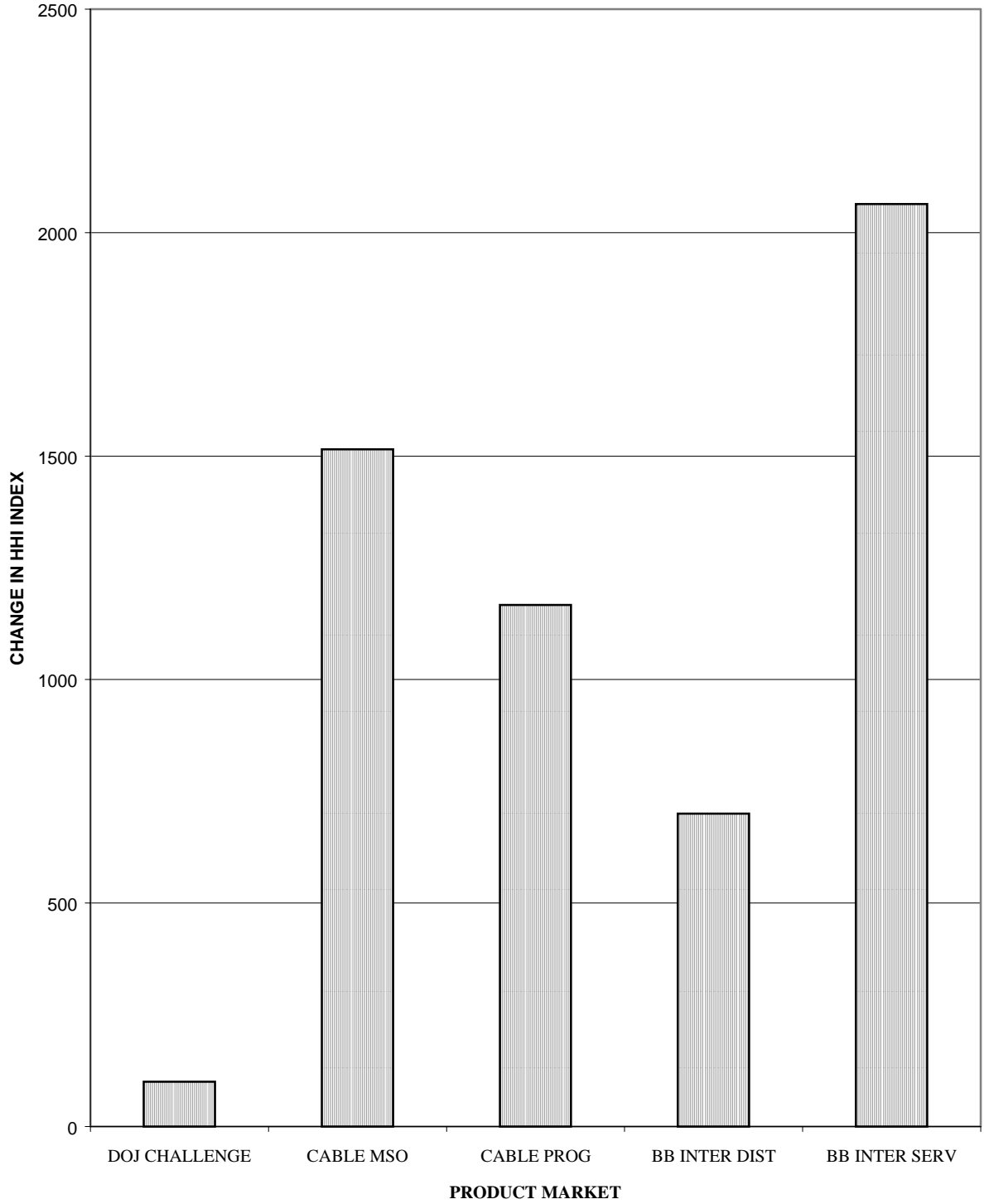
To summarize the problem briefly, the Merger Guidelines state that the Department of Justice is likely to challenge mergers in moderately and highly concentrated markets that raise the level of concentrations (as measured by the Hirschman Herfindahl Index (HHI)) by 50 to 100 points. All of the markets involved – cable distribution, cable programming, broadband Internet distribution and broadband Internet programming – are moderate to highly concentrated. The merger raises concentration in every one of these markets by between 1,000 and 3,000 points. In simple terms, this is not even a close call and in several markets the merger increases concentration dramatically.

2. VERTICAL CONCERNS

Although vertical mergers are less likely to be challenged as a general proposition, the AT&T-MediaOne merger and related deals presents unique and troubling characteristics. Large dominant players in related markets are merging. An acquisition strategy, not an expansion strategy, has been used to create a huge entity in a dominant position across several markets. In addition to the direct ownership and control of vertically integrated

³⁸ Department of Justice and Federal Communications Commission, *Merger Guidelines*, 1992.

**EXHIBIT 3:
HHI CHANGES IN MARKET CONCENTRATION
RESULTING FROM THE AT&T/MEDIAONE MERGER
COMPARED TO DOJ GUIDELINES**



activities, AT&T is using a variety of other means – contracts, leasing, etc. – to ensure vertical control.

The size and market reach of the firm raises questions about barriers to entry caused by the need for others to simultaneously enter multiple market. The closed access policy being defended by AT&T reinforces the need to enter multiple markets.

The closed access policy creates problems of price squeeze and quality discrimination. The network is being designed technologically, implemented contractually and managed operationally in a way that discriminates against unaffiliated service providers and precludes certain forms of commerce.

3. THE MERGER'S PERVASIVE STRUCTURAL IMPACT

The AT&T-MediaOne merger has a pervasive impact across several markets and involves four different aspects of market structure:

A **horizontal** merger is a marriage of rivals. It involves firms doing “the same” thing in “the same” market...

A **vertical** merger involv[es] companies in a supplier-customer relationship...

Conglomerate mergers...: [are] **market-extension**, mergers, in which the acquiring and acquired firms do the same thing in different geographic markets; **product-extension** mergers, in which the products (or activities) of the partners do not compete with each other but have some functional relationship in production or distribution.³⁹

³⁹ Asch, Peter, *Industrial Organization and Antitrust Policy* (John Wiley and Sons, New York: 1983), pp. 262-263.

The AT&T proposal to purchase MediaOne and the subsequent deals that have been struck with Comcast and Microsoft⁴⁰ result not only in a huge financial transaction but one that contains elements of every type of merger. The deal has elements of horizontal merger in cable distribution and horizontal merger in cable programming. It has elements of vertical integration between programming and distribution. It has elements of conglomeration of geographic and product markets.

As described in Exhibit 4, the horizontal aspects of the merger involve mergers between cable distribution systems (to the extent that they do or can compete in regional and national markets). It involves concentration of cable programming (to the extent that programs compete to gain access to customers). It involves concentration of Internet programming (to the extent that @Home and RoadRunner sell the same thing to the public).

⁴⁰ There is some sense in which the side deals may have been necessary to preserve cooperative relations among the various companies, a source of concern itself. *A New York Times* ("Key to Deal for MediaOne: Keeping the Losing Bidder Happy," May 6, 1999, story describes the side deals as follows:

Comcast had sought help from Microsoft the previous week, hoping that the software giant would dig into its \$22 billion cash coffer to aid the company in its bid. But even as Microsoft's chief financial officer, Gregory Maffei, met that week with Comcast at the offices of Sullivan & Cromwell, Microsoft's law firm, the Comcast team knew that Microsoft representatives were simultaneously meeting with its rival, AT&T, indicating that Microsoft might only be using the talks with Comcast as leverage in the AT&T negotiations... But AT&T executives also knew it was wiser to strike a friendly deal with the cable operator with which it hoped to do business in the future...

Why was AT&T eager to be the industry goliath, willing to give up control of more than four million subscribers? Company executives did not talk publicly, but one person involved in the talks noted that it would behoove AT&T -- which is trying to offer local telephone service through alliances with cable companies -- not to alienate Comcast. "Having Comcast, which control six million homes, or 10 percent of the cable industry, as an avowed enemy for life was not smart," said the participant on the condition of anonymity.

EXHIBIT 4
MARKET STRUCTURE ASPECTS OF THE
AT&T-MEDIAONE MERGER AND RELATED DEALS

MERGER IMPACT	CABLE	BROADBAND INTERNET
HORIZONTAL CONCENTRATION	DISTRIBUTION TCI/MediaOne, Comcast deal	DISTRIBUTION TCI/MediaOne,
	PROGRAMMING TCI/TWE/MediaOne	PROGRAMMING @Home/Road Runner
VERTICAL INTEGRATION	PROGRAMMING/ DISTRIBUTION TCI/TWE/MediaOne	PROGRAMMING/ DISTRIBUTION @Home/Road Runner- TCI/TWE/MediaOne
		DISTRIBUTION/EXHIBITION AT&T/Microsoft
MARKET EXTENSION	CABLE COVERAGE	INTERNET COVERAGE
PRODUCT EXTENSION	CABLE/BROADBAND CONVERGENCE	

The vertical aspects of the merger involve the integration of programming and distribution. In cable, MediaOne's programming and distribution will be integrated with the previously acquired TCI programming and distribution. In broadband Internet services the merger integrates programming and distribution services to the extent that @Home and RoadRunner are not currently integrated with a much larger distribution network. It involves the integration of distribution and equipment (the design and operation of the set top box by programming and distribution entities), through the deal with Microsoft.

To the extent that distribution is considered a local market, the merger constitutes market-extension, since much greater coverage is achieved. To the extent that the purpose of the merger is to utilize the broadband network to distribute cable, Internet and telephone service, it constitutes product-extension.

Economic and antitrust policy has generally been most adverse to horizontal mergers and least adverse to conglomerates, but it can, under certain circumstances, find fault with a merger that involves any one of the above areas. Needless to say, a merger that involves all four should be subject to extremely close scrutiny.

4. MARKET POWER GAINED BY MERGER, NOT EXPANSION

Second, we note that the issue here is not simply size or vertical integration, as such, but size and vertical integration through merger. If AT&T had increased its size or effectuated this integration through expansion into new areas, there would be no debate about its action. The merger literature places considerable importance on the decision to attack markets through merger, rather than expansion.

[V]ertical merger may have an adverse competitive impact by eliminating specific potential entrants who could integrate by vertical expansion rather than merger.⁴¹

In this case, the fact that AT&T has chosen the merger route takes on even greater significance because it contemplated other routes. It was a self-declared competitor whose decision to buy rather than fight is especially troubling. AT&T announced at least two other

⁴¹ Perry, Martin K., "Vertical Integration: Determinants and Effects," in Richard Schmalensee and Robert D. Willig (Eds), *Handbook of Industrial Organization* (North Holland, Amsterdam: 1989), p. 247.

decisions to follow a market expansion path to increasing its size and scope of activities, but it abandoned these approaches.⁴² It now claims that other companies can and should take the expansion route, which it rejected. It is ironic that AT&T now claims that its effort to achieve vertical integration through merger should be allowed because other firms can accomplish the same thing through expansion that it could not. If AT&T could not expand into these fields when they were not dominated by one huge, vertically integrated firm, it is hard to see how smaller rivals can overcome a larger obstacle.

D. BREAKING THE RULES BY DIVERTING ATTENTION FROM MARKET POWER

Before we begin the detailed analysis of concentration, it is important to point out what this paper does not consider. It does not analyze competition in the local telephone market. It does not contemplate changing the guidelines on ownership limitations. It does not consider changing the rules on attribution of ownership and control of corporations. It does not consider these things and policymakers should not.

If regulators go down that path, each merger will ask for a special exception from the general principles of consumer protection and there will be nothing left. Public policy to protect consumers from the abuse of market power will be completely undermined if regulators allow specific deals to rewrite the rules. This merger breaks all the rules, as they stood before it was proposed, and it should be stopped.

⁴² Ironically, one of the technologies AT&T abandoned – wireless loop – is one it claims will be a competitor.

The merger violates rules and guidelines by a wide margin. This is not a case of a close call that can be mitigated by small changes. The rules and guidelines that the merger violates are not “antiquated” relics of some past industrial age. All were adopted less than a decade ago. Nor is AT&T seeking exceptions from the rules in industries that are immune from anticompetitive abuse. The primary industry in which the rules and guidelines are being violated – cable TV – was just last year called by the Department of Justice one of the nation's “most durable and powerful monopolies.”⁴³ The other industry in which the merger would have its anticompetitive impact (broadband Internet services) involves an industry and another company (Microsoft) that have already raised concerns at the Department of Justice.⁴⁴

How could one of America’s most trusted corporations disregard such clear evidence that the merger breaks the rules and expect to sail the merger through without encountering significant regulatory hurdles? The answer is that AT&T establishes a series of diversions to deflect attention away from the fundamental issues raised by the merger and its related deals.

1. LOCAL TELEPHONE COMPETITION

The first diversion is to concentrate on local telephone competition. By concentrating on its promise to provide facilities-based competition for local telephone services, AT&T is attempting to divert attention from its dominance in other markets. Policy makers are backed into a corner by AT&T’s claim that the only way to get local telephone competition is to

⁴³ Wilke, John R., “antitrust Suit Filed to block Primestar Purchase,” *Wall Street Journal*, May 13, 1998.

⁴⁴ A consumer view of the case is provided in *The Consumer Case Against the Microsoft Monopoly* (Consumer Federation of America, Media Access Project and U.S. PIRG: October 1999).

allow the creation of a near national monopoly over cable TV wires (which also creates a clear monopoly over broad-band Internet services). Policymakers should reject this diversion for several reasons.

First, as a general principle, they should not trade massive increases in market power in one industry for a potential reduction in market power in another industry.⁴⁵

Second, with respect to the specific market, it is doubtful whether the competition that AT&T would actually bring to the local market would be worth the damage it would do to the cable TV and broadband Internet markets. This is the fifth local entry strategy that AT&T has declared since the passage of the Telecommunications Act.⁴⁶ In spite of the fact that AT&T is the largest telecommunications company in the country and has a history of providing local telephone service, it has proven to be far from an effective local service competitor.⁴⁷ There is no reason to believe it will do any better with this strategy than it has with its others.

⁴⁵ Consumer organization have been among the most vigorous critics of Regional Bell Operating Company failure to open local markets and their grossly inflated claims to consumer savings from premature entry into the long distance market (see Consumer Federation of America, *Stonewalling Local Competition: The Baby Sell Strategy to Subvert the Telecommunications Act of 1996* (January 1998), *Affidavit of Mark N. Cooper on Behalf of the Consumer Federation of America*, before the Public Utility Commission of California R.93-04003, I.93-04-002, R.95-04043, R.85-04044, June 1998; *The Consumer Stake in Vigorous Competition in the Illinois Local Telephone Market*, March 1999). We apply this same principle within the telecommunications industry. One of the fundamental principles we have advocated in opposing premature entry by the RBOCs into long distance is that even if there are small gains to made with long distance entry, they should not be achieved at the expense of lost gains from local competition.

⁴⁶ The five are resale, wireless loop, unbundled network elements, IP telephony over cable wires and circuit switched telephony over cable TV wires.

⁴⁷ For example, in August 1999, AT&T announced 6,000 residential subscribers in New York, the most open local market in the nation. In contrast, MCI claimed over 20 times as many residential subscribers.

Third, the economics of local telephone competition also make it highly unlikely that telephone competition is what this merger is about.⁴⁸ The money to pay for this merger comes from the exercise of market power in the cable TV and broadband Internet businesses, not competition for local telephone business.⁴⁹ AT&T's cost structure makes it virtually impossible to deliver significant price competition in local telephone service.⁵⁰

2. TRUST-ME SECURITIES

AT&T's second diversion lies in efforts to redefine ownership limits. AT&T wants authorities to water down or abandon their definitions of influence over companies through ownership or through control of customers. Where the ownership share is small AT&T wants the FCC to ignore it. Where it is large, AT&T wants the FCC to accept voluntary safeguards as a check on concentration of ownership.

AT&T argues that its programming subsidiaries have complete independence. Liberty Media is a tracking stock. Time Warner has a management committee. In essence, AT&T claims to have voluntarily renounced its property rights in and ability to influence its own

⁴⁸ AT&T's acquisition costs per subscriber of \$4000 to \$4500 are four times the FCC's most recent estimate of the economic costs of building an efficient telephone network (see Federal Communications Commission, *Synthesis Proxy Cost Model Results*, Version 2.6).

⁴⁹ Estimates of revenues to support deployment of two-way cable networks list telephone revenues as the smallest contributor (see Morgan Stanley Dean Whitter, *The Digital Decade*, U.S. and the America Investment Research, April 6, 1999, p. 11; Higgins, John M, "All For Just \$5,000," *Broadcast and Cable*, May 10, 1999).

⁵⁰ In the course of refuting RBOC claims on efficiency CFA has estimated potential long-term efficiency gains in local telephony on the order of approximately \$10 billion per year. This estimate assumes a cost structure similar to that embodied in the FCC's Synthesis Proxy Cost Model. AT&T's acquisition cost of MediaOne and its combined acquisition/upgrade cost of TCI indicate it could not place the downward pressure on local prices necessary to achieve these cost savings. Given the abuse of market power in the cable industry and the potential for abuse in broadband, the unique value of gaining AT&T as a local telephone competitor is doubtful at best.

subsidiaries. AT&T wants the federal authorities to accept these voluntary agreements as a substitute for true separation of ownership and independence of financial interests.

Policymakers should easily see through this diversion. In AT&T's theory, the company could own all the property in the industry and still pass regulatory muster, if it set up enough voluntary, artificial separations. That is a path that policymakers should decline to go down now, just as they did when AT&T proposed it as an alternative to breaking up the old end-to-end telephone monopoly. The independence is a charade. A recent column in *USA Today*, makes the point, citing, ironically, officials of Microsoft among others.

Microsoft is debating whether to proceed, Chief Financial Officer Greg Maffei told analysts last week. Tracking stocks bring a mess of complications. They require extra accounting and effort to keep employees and investors from feeling slighted by the allocations of resources to sibling businesses.

Says [Jeffrey] Haas [a tracking stock expert at New York Law School]: "the problem with this structure is that it lends itself to favoritism by executives and directors without recourse." Jeremy Stein, professor at Massachusetts Institute of Technology, notes tracking stocks have been described as "trust-me securities," companies are asking to be trusted not to take from the pockets of one set of shareholders and give to another whose business may be slipping.

The temptation to violate the trust would increase in a recession, particularly because tracking stocks are at risk to debts of the entire corporation. Haas says trackers are "financial Siamese twins" who both suffer if one becomes ill...

When hard times come, says lawyer John D'Alimonte of Willkie Farr, directors will squirm trying to deal with conflicting interests as share prices fall.⁵¹

Regulators do not have to rely on general concerns about "trust-me securities" to understand why they should see through this diversion. Liberty, the programming subsidiary

⁵¹ Henry, David, "Creating 'Tracking Stocks' Could Backfire," *USA Today*, July 29, 1999.

that that is supposed to be independent within the holding company, has been spun off from TCI and pulled back so many times its corporate logo should be a yo-yo.

3. OVERLY BROAD MARKET DEFINITIONS

AT&T's third diversion is to the define market in overly broad and "potential" terms. This diverts attention from the highly concentrated actual markets that AT&T will dominate. For example, AT&T argues that narrowband and broadband Internet services are in one market, even though broadband has 1000 times the speed. This is like claiming that the pony express and Federal Express are comparable forms of mail delivery.

Similarly, AT&T wants federal authorities to assume that future performance of competing technologies will prevent the current abuse of market power. AT&T wants regulators to bet on a technological breakthrough or a miraculous market transformation in failed technologies. Those are the very same technologies that have failed to prevent the abuse of market power in the very recent past. Consumers have been waiting for an alternative technology to break the monopoly power of the cable industry since it was largely deregulated in 1984. We hope such a breakthrough will occur, but merger and market power analysis should not be based on hope or hype.

D. CONCLUSION

Just two years ago the Federal Trade Commission (FTC) looked at a merger between Time Warner/Turner/TCI that looked very similar to the one that has been proposed by AT&T, which involves TCI and MediaOne (which owns a substantial stake in Time

Warner/Turner).⁵² The FTC rejected that merger and imposed conditions on it. It rejected a preferential deal for TCI purchase of Time Warner programming and required TCI to reduce its level of ownership in Time Warner to less than 10 percent of nonvoting stock (i.e. a non-attributable, passive level).

The FTC found that the programming market was concentrated.

The sale of Cable Television Programming Services to MVPDs in the United States is highly concentrated, whether measured by the Herfindahl-Hirschman Index (commonly referred to as “HHI”) or by two-firm and four firm concentration ratios.⁵³

The same is true today of the market for the sale of Television Programming Services to MVPDs (we refer to this as the cable programming market). The same is true of the broadband cable market. Indeed, this market starts at much higher levels of concentration.

The FTC found that “entry into the relevant markets is difficult,, and would not be timely, likely or sufficient to prevent anticompetitive effects.⁵⁴” With respect to the programming market it found

Entry into the production of Cable Television Programming Services for sale to MVPDs that would have a significant impact and prevent the anticompetitive effects is difficult. It generally takes more than two years to develop a Cable Television Programming Service to a point where it has a substantial subscriber base and competes directly with the Time Warner Turner “marquee” or “crown jewel” service throughout the United States. Timely entry is made even more difficult and time consuming due to a shortage of available channel capacity.⁵⁵

⁵² Federal Trade Commission, *In the Matter of Time Warner Inc., Turner Broadcasting Systems Inc., Telecommunications Inc. and Liberty Media Corporation*, Complaint, Docket No. , September 1997 (hereafter, Time Warner/Turner/TCI).

⁵³ Time Warner/Turner/TCI, pp. 6-7.

⁵⁴ Time Warner/Turner/TCI, pp. 7.

⁵⁵ Time Warner/Turner/TCI, pp. 7.

Much the same is true of that market today.

Given the underlying conditions, the FTC found that the merger would unacceptably increase concentration in the programming market.

The post acquisition HHI for the sale of Cable Television Programming Services to MVPDs in the United States measured on the basis of subscription revenues would increase by approximately 663 points, from 1,549 to 2,212 and will increase even further if Time Warner converts WTBS from a “superstation” to a cable network charging subscriber fees. Post acquisition, Time Warner will be the largest provider of Cable Television Programming Services to MVPDs in the United States and its market share will be in excess of 40 percent.⁵⁶

The impact of the AT&T/MediaOne merger would be even larger, resulting in an even more highly concentrated market programming market and a leading firm with an equally large market share. The increase in concentration in the broadband programming market is even more dramatic than the cable market.

The FTC found that the distribution market is highly concentrated.

The post-acquisition HHI for the sale of Cable Television Programming Service by MVPDs to households in each of the local areas in which Respondent Time Warner and Respondent TCI sell Cable Television is unchanged from the proposed acquisition and remains highly concentrated.⁵⁷

The same is certainly true today of the market for the sale of Cable Television Programming services to households (we refer to this as distribution). In every local market there is a virtual monopoly a MVPD distribution. The same is true of broadband Internet distribution.

⁵⁶ Time Warner/Turner/TCI, pp. 7.

⁵⁷ Time Warner/Turner/TCI, pp. 7.

The FTC found that entry into the distribution market is also difficult.

Entry into the sale of Cable Television Programming Services to households in each of the local areas in which Respondent Time Warner and Respondent TCI operate as MVPDs is dependent upon access to a substantial majority of the high quality, “marquee” or “crown jewel” programming that MVPD subscribers deem important to their decision to subscribe and that such access is threatened by increasing concentration at the programming level, combined with vertical integration of such programming into the MVPD level.⁵⁸

Little has changed in the cable markets identified by the FTC. Moreover, the severe vertical problems posed by the merger extend beyond cable TV services into broadband Internet services.

Because the cable operators are near monopolists in their local areas, traditional horizontal analysis does not find harm in mergers. The FTC concluded, we think incorrectly, that two monopolists are no better than one. However, the FTC did conclude that vertical aspects of the merger could harm competition in the distribution market.

Respondent Time Warner and Respondent Turner are actual competitors with each other and with other sellers in the sale of Cable Television Programming Services to MVPDs and Time Warner’s HBO, and Turner’s CNN, TNT and WTBS, are a large percentage of the limited number of “marquee” or “crown Jewel” Cable Television Programming Services which disproportionately attract subscribers to MVPDs.

Respondent Time Warner faces actual and potential competition from other MVPDs and potential MVPD entrants in the sale of Cable Television Programming services to households in each of the local areas in which it serves as an MVPD.

⁵⁸ Time Warner/Turner/TCI, pp. 7.

The effects of the agreements, if consummated, may be substantially to lessen competition in the relevant lines of commerce in the relevant sections of the country in violation of Section 7 of the Clayton Act.⁵⁹

The same is true of the broadband programming market. The two dominant firms in that market are joined by this merger and their domination would be even greater.

The enumeration of the ways in which the merger is a threat to lessen competition are instructive for both the cable TV and the broadband Internet markets. First with respect to programming the FTC saw a number of grounds for believing competition would be lessened.

enabling Respondent Time Warner to increase prices on its Cable Television Programming Services sold to MVPDs, directly or indirectly (e.g. by requiring the purchase of unwanted programming). Through its increased negotiating leverage with MVPDs, including through purchase of one or more “marquee” or “crown jewel” channels on purchase of other channels.

enabling Respondent Time Warner to increase prices on its Cable Television Programming Services sold to MVPDs by raising barriers to entry by new competitors or to repositioning by existing competitors, by preventing such rivals from achieving sufficient distribution to realize economies of scale; these effects are likely, because

- (1) Respondent time Warner has direct financial incentives as the post-acquisition owner of the Turner Cable Television Programming Services not to carry other Cable Television Programming Services that directly compete with Turner Cable Television Programming Services; and
- (2) Respondent TCI has diminished incentives and diminished ability to either carry or invest in Cable Television Programming Services that directly compete with the Turner Cable Television Programming Services because the PSA agreements require TCI to carry Turner’s CNN, Headline News, TNT and WTBS for 20 years, and because TCI, as a significant shareholder of Time Warner, will have significant financial incentives to protect all of Time Warner's Cable Television Programming⁶⁰

⁵⁹ Time Warner/Turner/TCI, pp. 7-8.

⁶⁰ Time Warner/Turner/TCI, pp. 8.

The cable TV programming market has not changed since the FTC made these observations and the merger recreates these anticompetitive incentives and sources of market power. The impact of the merger on the broadband programming market is even more powerful. AT&T is using the cable-broadband wire as its “crown jewel.” It conditions access to cable-based broadband transmission capacity on the taking of “unwanted programming.” Consumers must buy the @Home service before they can have access to other services over the broadband pipe.

The FTC also concluded that the merger could reduce competition in distribution markets by

denying rival MVPDs and any potential rival MVPDs of Respondent Time Warner competitive prices for Cable Television Programming Services, or charging rivals discriminatorily high prices for Cable Television Programming services.⁶¹

Little has changed in the vertically integrated, horizontally concentrated cable TV industry since the FTC reached those conclusions. The proposed merger places even more market power in the hands of AT&T. On the broadband side, price and quality discrimination are at the core of the @Home business model.

Thus, in both the traditional cable services and evolving broadband Internet services, at both the federal and local levels, the effort by a large, dominant firm to gain a commanding economic position on the information superhighway through merger and other forms of vertical domination have encountered resistance. The stiff resistance arises because the

⁶¹ Time Warner/Turner/TCI, pp. 8.

merger breaks recently enacted and clear rules regarding ownership and franchise authority under the Communications Act, as well as the merger guidelines adopted under the Sherman and Clayton Acts.

Although the FTC allowed the Time Warner/Turner/TCI merger to go forward with conditions, the AT&T/MediaOne merger poses a much more serious threat to consumers. The industry has become more highly concentrated and the broad picture of combined horizontal and vertical concentration/integration should spark greater concern. Given the web of cross ownership, joint ventures, and exclusive or preferential deals, the likelihood that any of the companies identified in Exhibit 2 will vigorously compete against the other companies in the cartel is slim.

II. THE ANTICOMPETITIVE IMPACT OF HORIZONTAL, VERTICAL AND CONGLOMERATE MERGERS INVOLVING DOMINANT FIRMS

A. THE OVERALL APPROACH TO THE ANALYSIS

This analysis relies on the structure, conduct performance (SCP) view of economic activity.⁶² Exhibit 5 presents the factors identified as playing an important role in the paradigm.⁶³ The SCP approach has been the dominant public policy paradigm in the United States for the better part of this century.⁶⁴ The elements of the approach can be described as follows.

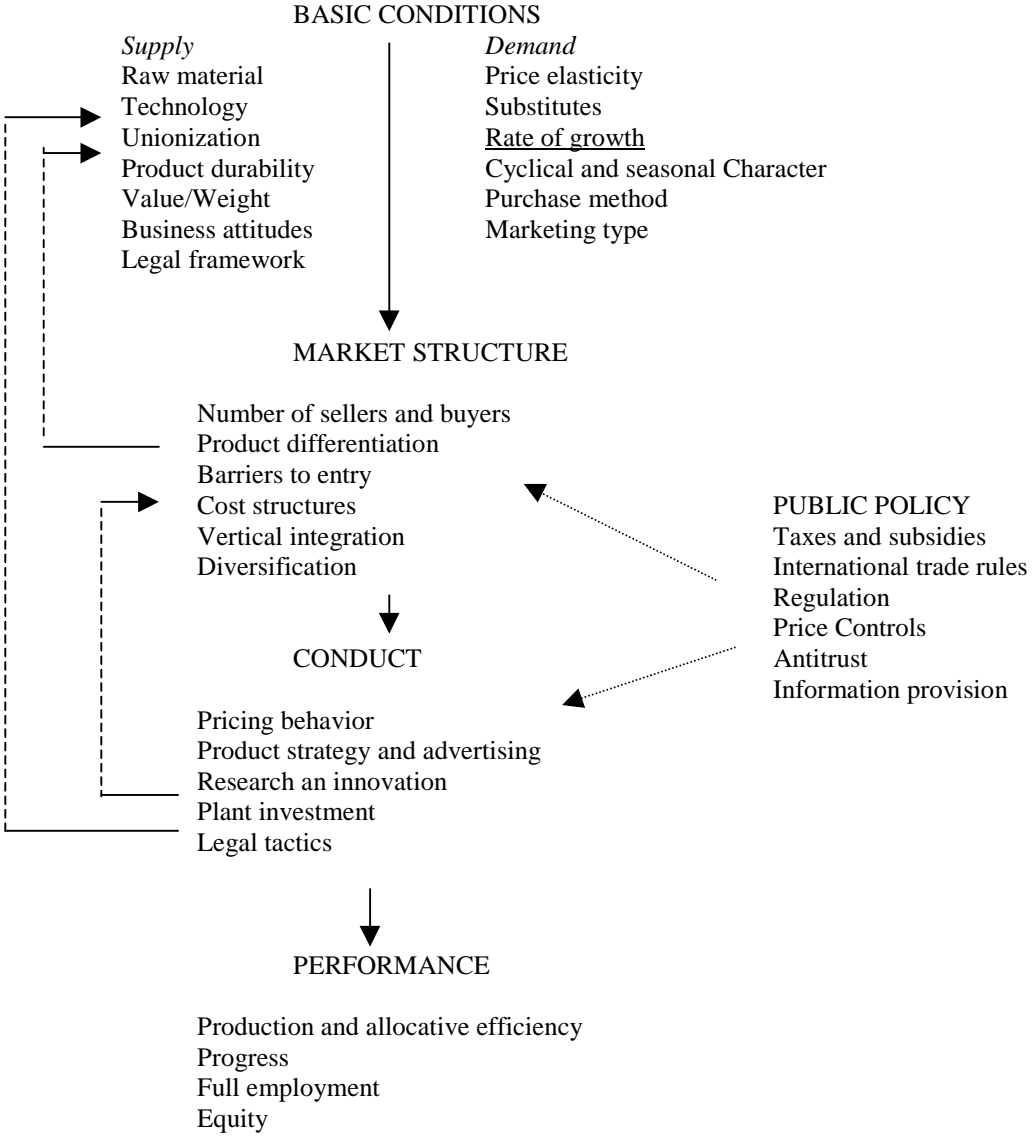
⁶² The Consumer Federation of America has applied a similar analysis to a variety of “network” industries including Consumer Federation of America, *Stonewalling Local Competition: The Baby Bell Strategy to Subvert the Telecommunications Act of 1996* (Consumer Federation of America, January 1998); *Open Skies Closed Airports* (Consumer Federation of America, February, 1997; *Economic Concentration and Diversity in Broadcast Media* (Consumer Federation of America, November 1995); *The Economics of Deregulation and Reregulation in the Cable Industry: A Consumer View* (Consumer Federation of America, September 1992), “Statement of Dr. Mark N. Cooper,” *In re: Petition of Consumers Union and the Consumer Federation of America to Update Cable TV Regulation and Freeze Existing Cable Television Rates*, MM Docket Nos. 92-264, 92-265, 92-266, September 22, 1997; and Consumer Federation of America and Consumers Union, *Residential Consumer Economics of Electric Utility Restructuring* (1998), *Electricity Restructuring and the Price Spikes of 1998*, June 1999; Consumer Federation of America and the Media Access Project, *The Consumer Case Against Microsoft* (October 1998).

⁶³ Shepherd, William, G., *The Economics of Industrial Organization* (Prentice Hall, Engelwood Cliffs, N.J., 1985), p. 5, presents a similar view.

⁶⁴ Scherer, F. M. and David Ross, *Industrial Market Structure and Economic Performance* (Boston, Houghton Mifflin: 1990), p. 4.

We seek to identify sets of attributes or variables that influence economic performance and to build theories detailing the nature of the links between these attributes and end performance. The broad descriptive model of these relationships used in most industrial organization studies was conceived by Edward S. Mason at Harvard during the 1930s and extended by numerous scholars.

EXHIBIT 5 THE STRUCTURE-CONDUCT-PERFORMANCE PARADIM



SOURCE: Scherer and Ross, F. M., and David Ross, *Industrial Market Structure and Economic Performance* (Houghton Mifflin Company: Boston, 1990), p. 5.

In SCP analysis the central concern is with market performance, since that is the outcome that affects consumers most directly. The concept of performance is multifaceted. It includes both efficiency and fairness.⁶⁵ The measures of performance to which we traditionally look are pricing and profits. Pricing and profits address both efficiency and fairness. They are the most direct measure of how society's wealth is being allocated and distributed.

The performance of industries is determined by a number of factors, most directly the conduct of market participants. Do they compete? What legal tactics do they employ? How do they advertise and price their products?⁶⁶ The fact that conduct is only part of the overall analytic paradigm is important to keep in mind.

⁶⁵ Scherer and Ross, p. 4.

We begin with the fundamental proposition that what society wants from producers of goods and services is good performance. Good performance is multidimensional... Decisions as to what, how much and how to produce should be efficient in two respects: Scarce resources should not be wasted, and production decisions should be responsive qualitatively and quantitatively to consumer demands.

The operations of producers should be progressive, taking advantage of opportunities opened up by science and technology to increase output per unit of input and to provide consumers with superior new products, in both ways contributing to the long-run growth of real income per person. The operation of producers should facilitate stable full employment of resources... The distribution of income should be equitable. Equity is notoriously difficult to define, but it implies at least that producers do not secure rewards in excess of what is needed to call forth the amount of services supplied.

⁶⁶ Scherer and Ross, p. 4.

Performance in particular industries or markets is said to depend upon the conduct of sellers and buyers in such matters as pricing policies and practices, overt and taciturn interfirm cooperation, product line and advertising strategies, research and development commitments, investment in production facilities, legal tactics (e. g. enforcing patent rights), and so on.

Conduct is primarily a product of other factors. Conduct is affected and circumscribed by market structure. Market structure includes an analysis of the number and size of the firms in the industry, their cost characteristics and barriers to entry, as well as the basic conditions of supply and demand.⁶⁷

Regardless of how much weight one gives to the causal assumptions of the paradigm, giving more or less weight to basic conditions or market structure, the list of variables is important. These are the factors that make markets work.⁶⁸

B. MERGER ANALYSIS IN THE SCP PARADIGM

Mergers are an especially important event in the analytic paradigm because they rapidly and, in some cases, significantly alter the supply-side of the market.

⁶⁷ Scherer and Ross, p. 5.

Conduct depends in turn upon the structure of the relevant market, embracing such features as the number and size distribution of buyers and sellers, the degree of physical or subjective differentiation prevailing among competing seller's products, the presence or absence of barriers to entry of new firms, the ratio of fixed to total costs in the short run for a typical firm, the degree to which firms are vertically integrated from raw material production to retail distribution and the amount of diversity or conglomerateness characterizing individual firms' product lines.

Market structure and conduct are also influenced by various basic conditions. For example, on the supply side, basic conditions include the location and ownership of essential raw materials; the characteristics of the available technology (e.g. batch versus continuous process productions or high versus low elasticity of input substitution); the degree of work force unionization; the durability of the product; the time pattern of production (e.g. whether goods are produced to order or delivered from inventory); the value/weight characteristics of the product and so on. A list of significant basic conditions on the demand side must include at least the price elasticity of demand at various prices; the availability of (and cross elasticity of demand for) substitute products; the rate of growth and variability over time of demand; the method employed by buyers in purchasing (e.g. acceptance of list prices as given versus solicitation of sealed bids versus haggling); and the marketing characteristics of the product sold (e.g. specialty versus convenience shopping method).

⁶⁸ Scherer and Ross, p. 6.

We have saved for separate treatment a set of particularly important market structure-shaping forces – mergers, takeovers, and other legal transformations through which two or more formerly independent firms come under common control...

Few topics in industrial organization economics arouse more passionate debate than mergers and takeovers. Some see mergers as an important source of efficiency; others emphasize their prominence as an outlet for managerial empire-building instincts whose pursuit degrades, not enhances efficiency; still others focus on mergers' role in altering market structure and enhancing monopoly power.⁶⁹

Given the passionate debate over mergers, it is not surprising to find that mergers in general, and vertical integration through merger in particular, have come to be governed by a “rule of reason” or case-by-case approach in contemporary economic and legal analysis.⁷⁰ Because arguments can be made both for and against vertical integration through merger, in particular, economists and antitrust authorities judge each merger based on the facts of the specific case.⁷¹ They weigh claimed efficiency gains against likely harm to competition. They ask whether the efficiencies could be achieved in other ways that would not harm competition at all. When mergers are vertical, they are particularly concerned about the level of competition in each of the affected markets and the impact of the merger on competition across stages of production.

AT&T has offered up all of the textbook claims about the positive effects of its

⁶⁹ Scherer and Ross, p. 153... 198.

⁷⁰ Scherer and Ross, pp. 450-458, on the “Emergence of a Rule of Reason.”

⁷¹ Asch, chapter 14.

proposed merger and why competition will not be harmed.⁷² This paper takes the opposite view.⁷³ As we go through the economic and legal discussions, we find that under specific circumstances mergers are consistently likely to reduce competition and impose a cost on the public.

The horizontal problem presented by the AT&T/MediaOne merger is clear as noted in the previous chapter. A good case can be made that the merger violates horizontal standards or raises serious antitrust concerns in each of the stages of production – cable and Internet programming, cable and broadband distribution, and set top boxes. Horizontal concentration, the result of horizontal mergers, has been the most suspect type of merger activity.⁷⁴

⁷² AT&T Corp. and MediaOne Group, Inc., “Applications and Public Interest Statement,” *In the Matter of Applications for Consent to Transfer of Control of Licenses*, before the Federal Communications Commission

⁷³ As noted above, our arguments are generally associated with the structure conduct performance paradigm, which is in contrast to the Chicago school approach. There is little dispute that horizontal mergers can have negative consequences. Vertical mergers are more hotly debated but the central conclusion of SCP paradigm is that, as Scherer and Ross conclude “Our analysis reveals that under plausible circumstances, vertical integration downstream by an input monopolist can lead to enhanced monopoly power and price increases (p. 525)..

Scherer and Ross further identify specific factors that render the conclusion an open question (pp. 522...523).

One answer is that the world is a good deal more complex than assumed in the models generating the Chicago propositions. In particular, those models ignore the possibility of substitutions between monopolized and competitive upstream inputs. Relaxation of the simplifying assumptions shows that monopoly power may be (but is not necessarily) enhanced through vertical combinations...

However, there is also a minus that works contrary to the Chicago propositions. By extending its monopoly downstream operations, the integrated firm gains control over the downstream industry’s use of all inputs, and not merely the use of input X. In addition to controlling the proportions in which X and Y are used, the integrated monopolist can determine the amount of previously competitive input Y used and hence increases its control over the amount of downstream output. The result may be restriction of output relative to the preintegration case, and thus an increase in the downstream product’s price.

⁷⁴ Asch, Peter and Rosalind Senaca, *Government and the Marketplace* (Dryden Press, Chicago: 1985), pp. 192-195.

The firm may simply buy out its rivals, merging with them to get a high combined market share for the new larger firm. Once unified, the former competitors no longer compete with one another.⁷⁵

The corporate merger is the ultimate form of collusion: when two firms merge they cease to have separate identities and act thereafter as a single unit...

The horizontal merger [is] the most troubling form from a policy point of view (due to its effect on concentration) and the one that is subject to the closest scrutiny from antitrust authorities. The reason for economists concern with horizontal combinations can best be seen by exploring the relationship between industry concentration and price.⁷⁶

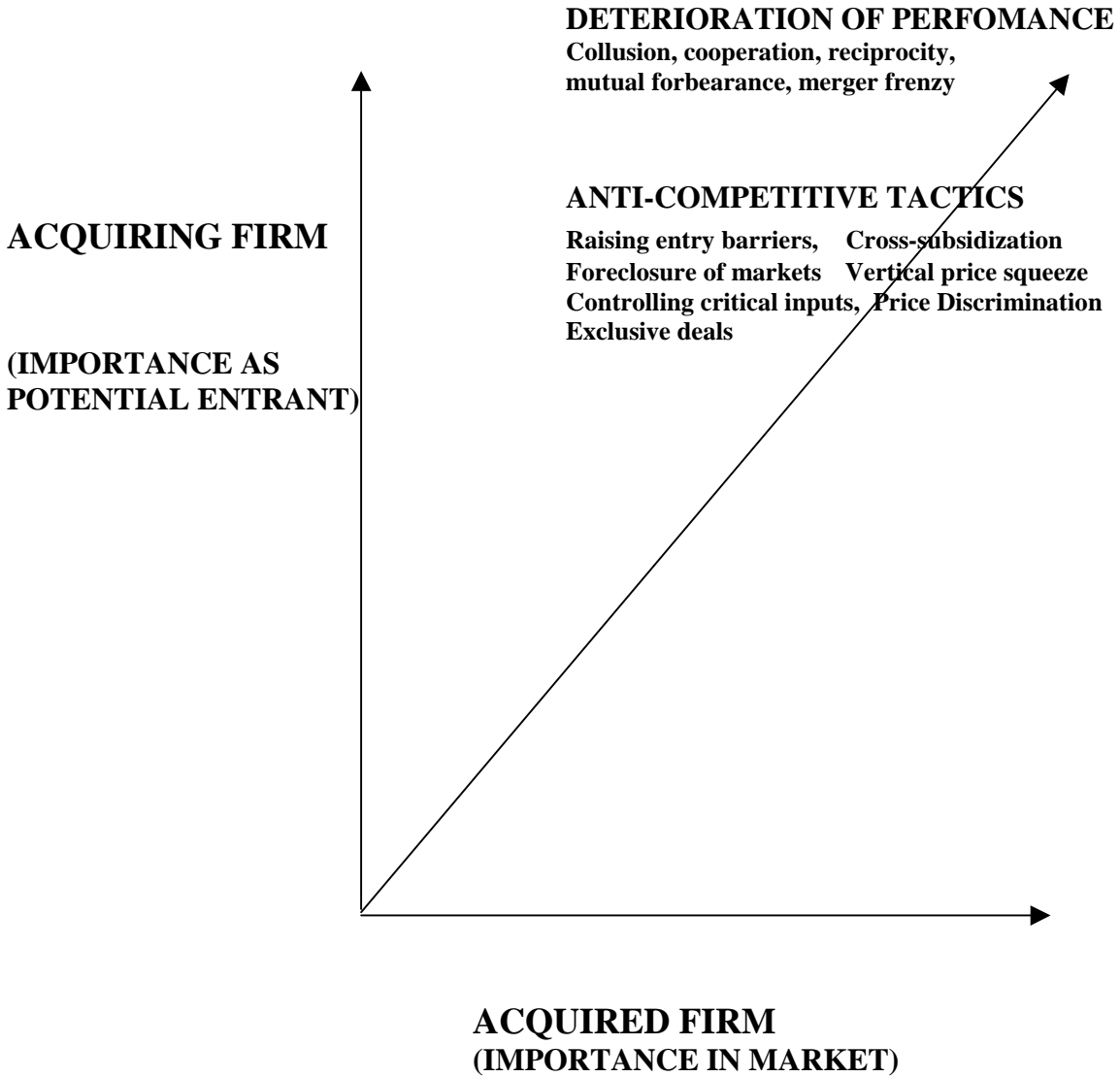
It is also notable that the vertical aspects of the merger and related deals raise concerns. Exhibit 6 summarizes the anticompetitive conduct and negative market performance that can emerge from the weakened market structures that result from the particular type of concentration caused by the AT&T-MediaOne merger and its related transactions. These vertical impediments to effective competition are overlaid on the horizontal problems in the individual industries that the consolidation spans.

The proposed AT&T deal possesses each of the most troubling characteristics. As a result, we conclude that this merger has a high probability of imposing substantial harm on the public. The most succinct statement from the general literature that captures the problems with such a merger is from William Shepherd who concludes that:

⁷⁵ Shepherd, p. 28.

⁷⁶ Jacquemin, Alexis and Margaret E. Slade, "Cartels, Collusion and Horizontal Merger," in Richard Schmalensee and Robert D. Willig, Eds., *Handbook of Industrial Organization* (North-Holland: New York, 1989), p. 430.

**EXHIBIT 6:
THE SPECIAL PROBLEM OF CONGLOMERATES**



Shepherd, William G. The Economics of Industrial Organization (Prentice Hall, Englewood Cliffs, N.J., 1985), pp. 289-304.

The “ideal” conglomerate merger is by an unexpected entrant acquiring a minor firm. By contrast, if an important potential entrant buys up a dominant firm (or vice versa), competition will be doubly reduced.⁷⁷

Large costs could arise if the two merging firms are both heavily dominant at their levels, and capital barriers are high at one level.⁷⁸

In Chapter IV we demonstrate each of these vertical problems in the merger.

C. CONCEPTUALIZING AND MEASURING MARKET POWER

1. COMPETITION AND MARKET POWER

Measuring concentration for purposes of market structure analysis has received a great deal of attention. Market structure analysis is used to identify situations where a small number of firms control a sufficiently large part of the market as to make coordinated or reinforcing activities feasible. Through various implicit and explicit mechanisms a small number of firms can reinforce each other's behavior, rather than compete. Identification of when a small number of firms can exercise this power is not a precise science. Generally, however, when the number of significant firms falls into the single digits, there is cause for concern, as the following suggests.

Where is the line to be drawn between oligopoly and competition? At what number do we draw the line between few and many? In principle, competition applies when the number of competing firms is infinite; at the same time, the textbooks usually say that a market is competitive if the cross effects between firms are negligible. Up to six firms one has oligopoly, and with fifty firms or more of roughly equal size one has competition; however, for sizes in between

⁷⁷ Shepherd, p. 304.

⁷⁸ Shepherd, p. 292.

it may be difficult to say. The answer is not a matter of principle but rather an empirical matter.⁷⁹

The clear danger of a market with a structure equivalent to only six equal sized firms was recognized by the Department of Justice in its Merger Guidelines.⁸⁰ These guidelines were defined in terms of the Herfindahl-Hirschman Index (HHI). This measure takes the market share of each firm squares it, sums the result and multiplies by 10,000.⁸¹

A market with six equal sized firms would have a HHI of 1667. The Department declared any market with an HHI above 1800 to be highly concentrated. Thus, the key threshold is at about the equivalent of six or fewer firms.

Another way that economists look at a market at this level of concentration is to consider the market share of the largest four firms (called the 4-Firm concentration ratio).⁸² In a market with six equal sized firms, the 4-Firm concentration would be 67 percent. The

⁷⁹ J. W. Friedman, Oligopoly Theory (Cambridge: Cambridge University Press, 1983), pp. 8-9.

⁸⁰ U.S. Department of Justice, Merger Guideline, revised, 1992.

⁸¹ Shepherd, p. 389, gives the following formulas for the Hirschman Herfindahl Index (HHI) and the Concentration Ratio (CR):

$$H = \sum_{i=1}^n \frac{p_i^2}{p}$$

$$CR = \sum_{i=1}^m \frac{p_i}{m}$$

where

n = the number of firms

m = the market share of the largest firms (4 for the 4 firm concentration ratio)

p = the share of the ith firm.

i

⁸² See note 59.

reason that this is considered an oligopoly is that with a small a number of firms controlling that large a market share, their ability to avoid competing with each other is clear.

Shepherd describes this threshold as follows:⁸³

Tight Oligopoly: The leading four firms combined have 60-100 percent of the market; collusion among them is relatively easy.

While six is a clear danger sign, theoretical and empirical evidence indicates that many more than six firms are necessary for competition – perhaps as many as fifty firms are necessary. Reflecting this basic observation, the Department of Justice established a second threshold to identify a moderately concentrated market. This market was defined by an HHI of 1000, which is equivalent to a market made up of 10 equal sized firms. In this market, the 4-Firm concentration ratio would be 40 percent.

Shepherd describes this threshold as follows:

Loose Oligopoly: The leading four firms, combined, have 40 percent or less of the market; collusion among them to fix prices is virtually impossible.⁸⁴

Shepherd also notes that a dominant firm – “one firm has 50-100 percent of the market and no close rival”⁸⁵ – is even more of a concern.⁸⁶

⁸³ Shepherd, p. 4.

⁸⁴ Shepherd, p. 4.

⁸⁵ Shepherd, p. 4.

⁸⁶ The Department of Justice Guidelines of 1984 had a dominant firm proviso, which was dropped in the 1992 update.

2. THE SPECIAL IMPORTANCE OF PREVENTING CONCENTRATION OF MARKET POWER IN COMMUNICATIONS MEDIA

Even the moderately concentrated threshold of the Merger Guidelines barely begins to move down the danger zone of concentration from 6 to 50 equal sized firms. For a "commodity" with the importance of telecommunications, certainly this moderately concentrated standard is a more appropriate place to focus in assessing the structure of the market.

The Bill of Rights established the principle that the press plays a special role in politics. Diversity of political ideas available through the public media is believed to be a cornerstone of vibrant and free political debate. While the print media dominated the first century and a half of American political life, the enactment of the Communications Act of 1934 extended the commitment of public interest obligations to the broadcast media. In fact, the concerns about the important role of mass communications have only been redoubled as electronic media have come to dominate political discourse and cultural value formation.

Because policymakers recognize the uniquely important role that broadcast media - radio and later television -- play in the marketplace of political ideas and in forming cultural values, they have imposed more explicit standards on the industry. Above all, policymakers have rejected the notion that economics alone should decide the nature, availability, and content of political and cultural programming. Instead, policy has sought to prevent concentration of economic power from controlling the flow of ideas in the broadcast media by placing limits on the ownership of media outlets and imposing obligations to expand

programming beyond what is simply profitable.⁸⁷ In short, what is good enough in the economic marketplace has not been considered to be good enough in the political and cultural marketplace.

Almost three-quarters of a century of public policy toward the mass media have been predicated on the recognition of the uniquely powerful impact of that media.⁸⁸ Broadband Internet services takes the role of the broadcast media to a higher level adding interactivity to immense reach,⁸⁹ real time immediacy,⁹⁰ and visual impact,⁹¹ Because it is such a potent method of information dissemination, economic control over mass media can result in excessive political power.⁹²

In other words, in simple economic markets levels of concentration typified by 10 equal sized firms are high enough to raise questions about the competitive behaviors of the

⁸⁷ The Federal Communications Commission, Further Notice of Proposed Rulemaking in the Matter of Review of the Commission's Regulations Governing Television Broadcasting, MM Docket No. 91-221, January 17, 1995, pp. 54-55).

⁸⁸ C. M. Firestone and J. M. Schement, Toward an Information Bill of Rights and Responsibilities (Aspen Institute, Washington, D.C., 1995), p. 45

⁸⁹ Bagdakian describes the economic and cultural impact of television as follows (p. 182):

⁹⁰Gigi Sohn and Andrew Jay Schwartzman, "Broadcast Licensees and Localism: At Home in the 'Communications Revolution,'" Federal Communications Law Journal, December 1994; M. Griffin, "Looking at TV News: Strategies for Research," Communication, 1992.

⁹¹ Kathryn Olson, "Exploiting the Tension between the New Media's "Objective" and Adversarial Roles: The Role Imbalance Attach and its Use of the Implied Audience," Communications Quarterly 42: 1, 1994 (pp. 40-41); A. G. Stavitsky, "The Changing Conception of Localism in U.S. Public Radio," Journal of Broadcasting and Electronic Media, 1994.

⁹² P. C. Washburn, "Top of the Hour Radio Newscasts and the Public Interest," Journal of Broadcasting and Electronic Media, 1995, pp. 74-75.

Widespread belief in economic competition as the foundation for a genuine "marketplace of ideas" was exploited effectively by the Reagan administration and by powerful corporations such as AT&T, ITT, General Electric, CBS, Capital Cities, and IBM to eliminate much of the regulatory structure of America's communications industry.

firms in the market. Given the nature of the telecommunications industry and the special concern about the free flow of ideas, this is a conservative level of concentration about which to be alarmed.

As demonstrated in the next chapter, by these standards, the AT&T deals pose a horrendous problem of concentration and presents a severe threat to the public interest.

III. THE CONCENTRATION IN THE CABLE TV AND BROADBAND INTERNET MARKETS

A. THE HORIZONTAL CABLE MARKET POWER PROBLEM POSED BY THE MERGER

The central characteristic rendering the AT&T merger and related deals is suspect is that it involves a dominant firm in concentrated industries becoming more dominant horizontally, rendering those horizontal markets more concentrated. This concentrated horizontal base links vertically to the other stages of production.

1. CABLE DISTRIBUTION

Exhibit 7 presents a count of the number of subscribers and homes passed that are in play in the AT&T deals. We say in play because different views of the attribution of ownership will lead to different counts and the actual structure of the deal is still in flux. AT&T's filing makes vague references to other deals in the works.⁹³

We consider both subscribers and homes passed because different aspects of the merger review focus on these numbers. For example, the subscriber number is particularly relevant to Department of Justice review, since this is the actual market for cable services. Homes passed, is the potential market for cable and broadband. It is also the referent for the

⁹³ AT&T Filing.

EXHIBIT 7

AT&T'S CABLE, BROADBAND, AND TELEPHONE REACH (COUNTS AS FILED AT THE FCC AND USING FCC RULES)

SYSTEM	MILLIONS OF HOUSEHOLDS	
	SUBSCRIBERS	HOMES PASSED
<u>AT&T ATTRIBUTABLES</u>		
TCI OWNED AND OPERATED	10.7	17.2
TCI/CONSOLIDATED	.7	1.8
TCI/NON-CONSOLIDATED	10.4	15.2
MEDIAONE	4.9	8.5
TIME WARNER-MEDIA ONE	9.7	15.2
LESS COMCAST NET GAIN		
TO DATE	.7	1.2
FUTURE	1.3	1.7
AT&T TOTAL	34.4	55.0
NATIONAL TOTAL	74.0	96.0
AT&T PERCENT OF NATIONAL	49	57
COMCAST	6.4	8.5
TOTAL IN CONGLOMERATE	40.4	64.3

SOURCES: AT&T Corp. and MediaOne Group, Inc., "Applications and Public Interest Statement," *In the Matter of Applications for Consent to Transfer of Control of Licenses*, before the Federal Communications Commission; "Higgins, John M., "Top MSOs Own 90% of Subs," *Broadcasting & Cable*, May 24, 1999; "FCC to Scrutinize AT&T MediaOne Deal," *Broadband Daily*, May 10, 1999; "AT&T Household Reach to be Issue in MediaOne Merger Review," *Communications Daily*, May 10, 1999.

horizontal limit rule established by the FCC. The homes passed number is also a measure of the broadband and telephone market that AT&T could reach.

The top part of the table includes all of the subscribers and homes passed that should be attributed to AT&T. This is a combination of wholly and partially owned systems. Measured by the FCC's ownership attribution rules, we find that AT&T will have just under 35 million subscribers. This would give it just under 50 percent of the cable TV market. It would have about 55 million homes passed. This would give it just over 57 percent of the Multichannel Programming Video Distribution(MPVVD) market. It is well past the horizontal limit. Thus, the deal violates the public policy embodied in the 1992 Cable Act.

AT&T has argued to not include some of the systems in which it has ownership interests in its attributable total. For the reasons given in Chapter I, we do not believe that this is appropriate. AT&T has also argued that more households should be included in the base. That is, it wishes to include satellite in the count, which would raise the national total to about 80 million subscribers and the total homes passed to about 100 million. Even with these numbers in the base, it would violate the horizontal ownership limits (with about 44 percent of subscribers and 55 percent of homes passed). Only if regulators ignore the ownership relationships and expand the base does AT&T's horizontal presence come even close to the limits.

The problem goes even further. Measured by the FCC attribution rules, the merger would take a moderately concentrated market and move it significantly toward being highly concentrated. Exhibit 8 presents an estimate of the horizontal impact of the merger in the market where it has attracted the greatest attention – cable distribution.

EXHIBIT 8
INDICES OF CONCENTRATION AT THE NATIONAL LEVEL

	CFA/CU MARKET DEFINITION		FCC MARKET DEFINITION	
	MKT SHARE ATT (HOMES)	HHI	MKT SHARE ATT (HOMES)	HHI
1995	NA	1098	NA	1098
CURRENT BEFORE DEAL	36	1406	34	1225
WITH ATT/MEDIAONE DEAL	57	2633	55	2267

SOURCES: Federal Communications Commission, In the Matter of Annual Assessment of the Status of Competition in Markets for the Delivery of Video Programming, CS Docket No. 97-141, Fourth Annual Report, December 31, 1997, Appendix E, Table E-4., for 1995 and 1998. In addition to subscribers listed in Exhibit 7, the following subscriber numbers are used, Cox 5.1; Adelphia, 4.9; Direct TV 4.4; Charter, 3.7 and Jones, 1.

The Merger Guidelines of the Department of Justice indicate that a merger in a moderately concentrated industry (with an HHI index between 1,000 and 1,8000) that increases the concentration in such a market by 100 points would be subject to challenge. This merger raises the index by over 1000 points, even using the FCC number published in January of 1999.

Having noted that the merger poses substantial problems based on recently published FCC analyses, it should be noted that we believe that the FCC's definitions underestimate the extent of market concentration and market power for two reasons.

First, in 1998, for the first time, the FCC included direct broadcast satellite in the base for the calculation of industry concentration. This is not justified.⁹⁴ DBS costs several times as much as cable and does not compete on price. It certainly did not restrain cable price increases in 1997-1998. The DBS niche market is growing, but it did not slow the growth of cable. Cable subscribership increased more in 1997-1998 than it did in 1996-1997 and just about as much as it did in 1995-1996.

Second, the FCC analysis, based on mid-1998 numbers, did not include pending transactions, which would further concentrate the industry, even before the AT&T deals.

Taking these two factors into account, we conclude that the merger has an even larger impact and moves the industry into the highly concentrated range. AT&T's count of 35 million subscribers results in a market that exceeds the DOJ measure of highly concentrated by a wide margin, even with DBS in the base.

As previously noted, once AT&T found that policymakers in Washington take concentration in the cable industry seriously, it began to restructure its deals and to put pressure on the FCC to reconsider its approach to measuring ownership. Exhibit 9 describes the steps AT&T has taken and the redefinition that it wants the FCC to make in order to allow

⁹⁴ Cooper, Mark and Gene Kimmelman, *Digital Divide* (Consumer Federation of America and Consumers Union, Washington, D. C, 1999)

EXHIBIT 9
AT&T'S STRATEGY TO SLIP THE DEAL THROUGH

FULL DEAL	% HOMES PASSED	HHI
CFA/CU DEFINITIONS	57	2633
FCC DEFINITIONS	55	2267
AT&T REDEFNITION		
EXPANDED BASE SPIN OFF SUBS	48	2047
DO NOT COUNT TWE OWNERSHIP	33	957

the deal to go forward. First we have the spin off of approximately 4.5 million subscribers and the expansion of the base of subscribers and households in the homes passed count. This does not come close to solving either the merger guideline problem or the horizontal ownership problem. Only by having the ownership in Time Warner ignored (or spun-off) would the damage to industry structure be repaired.

Regardless of the precise measurement, this merger leaves AT&T with excessive horizontal control of cable distribution systems. The horizontal concentration rises to a level that is unprecedented in the industry. This create a unique and new barrier to entry in the horizontal dimension, since AT&T could use its vast footprint and leverage it market power to retaliate against an established MSO that sought entry into its region. This concern is in

addition to the programming concern expressed by the FTC. An excessively large purchaser could exercise market power by denying economies to potential entrants. The cable operators in which AT&T has an interest would be the largest purchaser of cable programming by far. This alone would give AT&T the ability to make or break programming.

2. CABLE PROGRAMMING

Measuring horizontal concentration in programming is more difficult, since programming is both national and regional and channel capacity differs across systems. Moreover, cable programming concentration has always had a vertical dimension to it. The analysis has always been focused on programming owned by MSOs, since as the owners of bottleneck facilities, MSOs could make or break programmers. The AT&T deals would have such a substantial impact on concentration in the industry that it could change the focus away from vertical to horizontal concerns.

As Exhibit 10 shows, there are 254 national and regional programming services listed in the FCC annual report on cable competition.⁹⁵ Of these about 45 percent are owned by MSOs in whole or in part (as per the attribution rules). The MSO share at the national level

⁹⁵ Federal Communications Commission, *In the Matter of Annual Assessment of Competition in markets for the Delivery of Video Programming*, CS Docket No. 98-102, December 23, 1998.

EXHIBIT 10
THE CABLE PROGRAMMING MARKET

	NUMBER	PERCENT OWNED BY MSO
NUMBER OF PROGRAMS	254	45
NATIONAL PROGRAMS	194	40
NATIONAL AUDIENCE (SUBSCRIBERS, Billion)	2.54	44
REGIONAL PROGRAMS	60	60

SOURCES: Federal Communications Commission, In the Matter of Annual Assessment of the Status of Competition in Markets for the Delivery of Video Programming, CC Docket No. 98-102, Fifth Report, Table D-1, D-2, D-3.

measured by number of programs is 40 percent; by subscribership it is about 44 percent. The MSOs have a larger numerical share of the regional programming. The MSO share of regional programs is about 60 percent.

The MSOs involved in the AT&T deals are quite prominent in the programming market shown in Exhibit 11. Time Warner and TCI (including Cablevision) are the dominant players by far. Subscriber counts are available only for national programming. Focusing only on the MSO involved in the AT&T deal, we find that the national market is

EXHIBIT 11
NATIONAL PROGRAMMING MARKET CONCENTRATION
ALL PROGRAMS IN BASE, MSO OWNED USED FOR CALCULATION

THE INCREASED CONCENTRATION IN THE CABLE PROGRAMMING
MARKET VIOLATES THE DOJ GUIDELINES

	MARKET SHARE (%)
TCI/CABLEVISION	32
TIME WARNER	16
COMCAST	5
MEDIAONE	2
HHI	
CURRENT	1301
TCI/TWE/M1 MERGER	2474

SOURCE: FCC ANNUAL REPORT

moderately concentrated (HHI of about 1300). If the TCI-Time Warner interests are allowed to merge by the consummation of the AT&T deals, the HHI jumps almost 1,000 points to 2282, well above the highly concentrated range. Adding in the consolidation of the programming interests of the other MSOs involved in the deal adds another 200 points to the index. Even this smaller change, given the level of concentration in the industry, should be challenged.

The dramatic increases in the concentration of programming and the vertical integration with the highly concentrated distribution market underscore the complaint lodged by the FTC in opposition to the Time Warner/Turner/TCI merger. The incentive and ability

to frustrate competitive entry in both distribution and programming through leveraging of programming is quite clear.

B.. BROADBAND INTERNET SERVICE

The market concentration problem in the realm of broadband Internet service parallels the cable industry problem.

1. DISTRIBUTION PLANT

The cable distribution plant is the dominant form of broadband Internet service. The homes passed numbers are particularly important in this regard. This is the market for Broadband Internet services and AT&T's reach is even greater in this market than as measured by cable subscribers.

Market definition becomes the central issue in deciding the impact of the merger on the broadband Internet market. If the market is defined narrowly as cable-based broadband Internet, there is no question that the merger poses a severe problem. If the market is defined broadly, to include narrowband Internet access, then it clearly does not, since @Home and Road Runner are small compared to AOL and other narrowband Internet service providers. We believe that the narrow definition is appropriate.

Distribution of Internet service over the telephone network is overwhelmingly narrowband, and cannot compete with broadband over cable. @Home describes its advantage over narrowband as follows:

Our primary offering, the @Home service, allows residential subscribers to connect their personal computers via cable modems to a high-speed Internet

backbone network developed and managed by us. This service enables subscribers to receive the “@Home Experience,” which includes Internet service over hybrid fiber co-axial, or HFC, cable at transmission speeds up to 100 times faster than typical dial up connections, “always on” connection and rich multimedia programming through our broadband Internet portal.

While narrowband can easily be excluded as a competitor for cable-based broadband because of its much slower speed, another technology delivered over the telephone network presents a more complex picture. Digital Subscriber Line technologies (referred to as xDSL), is being deployed over the telephone network. This technology is wideband and does not afford the speed of cable modems, with cable modems being up to six times as fast. Further, xDSL is restricted in the number of households it can pass by limitation of the distance the end-user can be located from the central office. It is also far behind in deployment and subscribers.

A Cisco Systems *White Paper* describing its cable oriented network equipment makes the point.

This paper discusses the opportunities that streaming-media technologies offer for the cable operator, as well as the architecture needed to support streaming-media services, and the economics of building out the required infrastructure and offering basic streaming media services...

Now, with the infrastructure for high-speed data services already being deployed, the cable industry is positioned to harness this trend to create services that combine on-demand, interactive, and broadcast services into a unique service offering. By offering both on-demand services and broadcast services, cable operators can effectively differentiate themselves from competing providers who can offer only on-demand delivery (for example, digital subscriber line [DSL]) or who can offer only broadcast services over large footprint (for example, digital satellite).⁹⁶

⁹⁶ Cisco Systems, *New Revenue Opportunities for Cable Operators From Streaming-Media Technology: A Case for Leveraging IP Technologies in Implementing VoD*, 1999.

Although Cisco is trying to sell systems to cable operators, this sharp difference between telephone company wideband and cable broadband has been noted by disinterested parties as well. One recent academic analysis presents a sharp contrast between constraint DSL capacity and cable broadband.

Maximum distance between the central office and the premise is 18,000 feet, which should reach more subscribers. ADSL... can deliver a 1.5-Mbps channel over a distance of 18,000, a 3-Mbps channel over a span of 12,000 feet, or a 6-Mbps channel over spans up to 8,000 feet long. It also provides a POTS voice circuit in both directions, plus a low-speed (16 Kbps) digital maintenance and control channel....

Cable TV companies are using cable modems and their existing H-F/C networks to offer broadband video, telephony, and data over their subscribers in competition with other local exchange providers. These modems and H-F/C provide 80 or more television channels in the downstream direction plus telephony and data transmission at rates from 4 to 10 Mbps in the upstream and downstream directions. Using the modems, cable companies can provide Internet and other data transport at rates 1,000 times those of the PTSN.⁹⁷

The near to mid term advantage of the cable TV plant rests on a number of factors.

Cable TV provides greater bandwidth immediately⁹⁸ that supports a much broader range of

⁹⁷ Nellist, John G. and Elliott M. Gilbert, *Understanding Modern Telecommunications and the Information Superhighway* (Norwood, MA, Artech House: 1999), pp. 137-1388... 147-148.

⁹⁸ Residential Broadband, p.22, 140, 145.

Early networks will use one of two forms of existing wiring (1) telephone lines terminated with Asynchronous Digital Subscriber Line (ADSL) modems capable of downstream speeds from 1 to 12 Mbps depending on distance; or (2) upgraded fiber/Coax CATV lines capable of two-way transmission and cable modems capable of 1 to 30 Mbps, depending on traffic (not distance) over the shared CATV line..

While CATV cannot deliver interactive broadband to many people now, the CATV plant upgrade is considerably quicker and cheaper than central office switch replacement. If the telephone companies want to play they will have to play with new facilities dedicated to broadband...

services, particularly the video entertainment services that seem to be driving consolidation and technology deployment in the industry.⁹⁹ It does not face problems in distribution including weather, geography and distance limitations¹⁰⁰ and a lower cost upgrade to provision high quality video services.

The limitations on xDSL undermine its potential as a residential service, orienting it more toward business.

Widespread availability of xDSL services has been a long time coming. Standards issues, copper line quality, noise interference with other technologies and reticence by telephone companies have prevented mass deployment. But a study by the Business Research Group in Newton, Mass., says 250,000 xDSL lines will be deployed by year's end. And service rollouts

But CATV networks have the one thing telephone networks lack, namely, inherent broadband speed... This is why many have come to believe CATV lights the future of residential broadband.

⁹⁹ Residential Broadband, p. 170.

First-generation ADSL network will support data traffic, principally, not video traffic.

¹⁰⁰ Residential Broadband, pp. 166-167.

CATV systems (HFC) will start with higher speeds, lose ground to many users sharing the same bandwidth, then recover (this is, move to another generation) by splitting nodes to reduce users per line.

The distinguishing feature of first-generation ADSL networks will be data rate. ADSL data rates depend principally upon line distance. The longest usable lines in the United States will only support ADSL rates of about 1.5 Mbps. However, 1.5 Mbps suits first applications – Internet and corporate LAN access... To squeeze the last ounce out of each line, ADSL-based network service providers will deploy a so-called Rate Adaptive ADSL that adjusts itself to the conditions and finds the fastest rate for a given line. Network service providers may put an upper limit on rate – a line capable of 6 Mbps may be restricted to 3 Mbps, for example, with what's left coming only with a higher tariff – but the longest lines with other impairments such as bridge taps may only yield 1 Mbps.

If we divide the entire capacity into 6-MHz channels and applied average modems to each channel, we could accumulate 6 Gbps of digital bandwidth, a capacity far exceeding what ordinary telephone lines can possibly provide.

are gaining momentum. According to Gary Cline, a principal analyst at BRG, 35 percent of ISPs will deploy xDSL this year...

Analysts predict cable won't compete directly with xDSL and that cable providers will end up catering to other markets...

"ADSL and cable modems don't compete," says Cline. "Cable modems are providing service to residential markets. @Home Network's @Work is the farthest you can go with cable."¹⁰¹

The business market is suited to xDSL because it does not require high quality video and loops are shorter.

Another Cisco Systems *White Paper* describing its cable oriented network equipment makes the point.

This paper discusses the opportunities that streaming-media technologies offer for the cable operator, as well as the architecture needed to support streaming-media services, and the economic of building out the required infrastructure and offering basic streaming media services...

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¹⁰¹ Cholweke, Kathleen, "XDSL: A Hire Wire Act," *Inter2active Week*, April 29, 1998.

¹⁰² Cisco Systems, *New Revenue Opportunities for Cable Operators From Streaming-Media Technology: A Case for Leveraging IP Technologies in Implementing VoD*, 1999.

parties as well. One recent academic analysis presents a sharp contrast between constraint DSL capacity and cable broadband.

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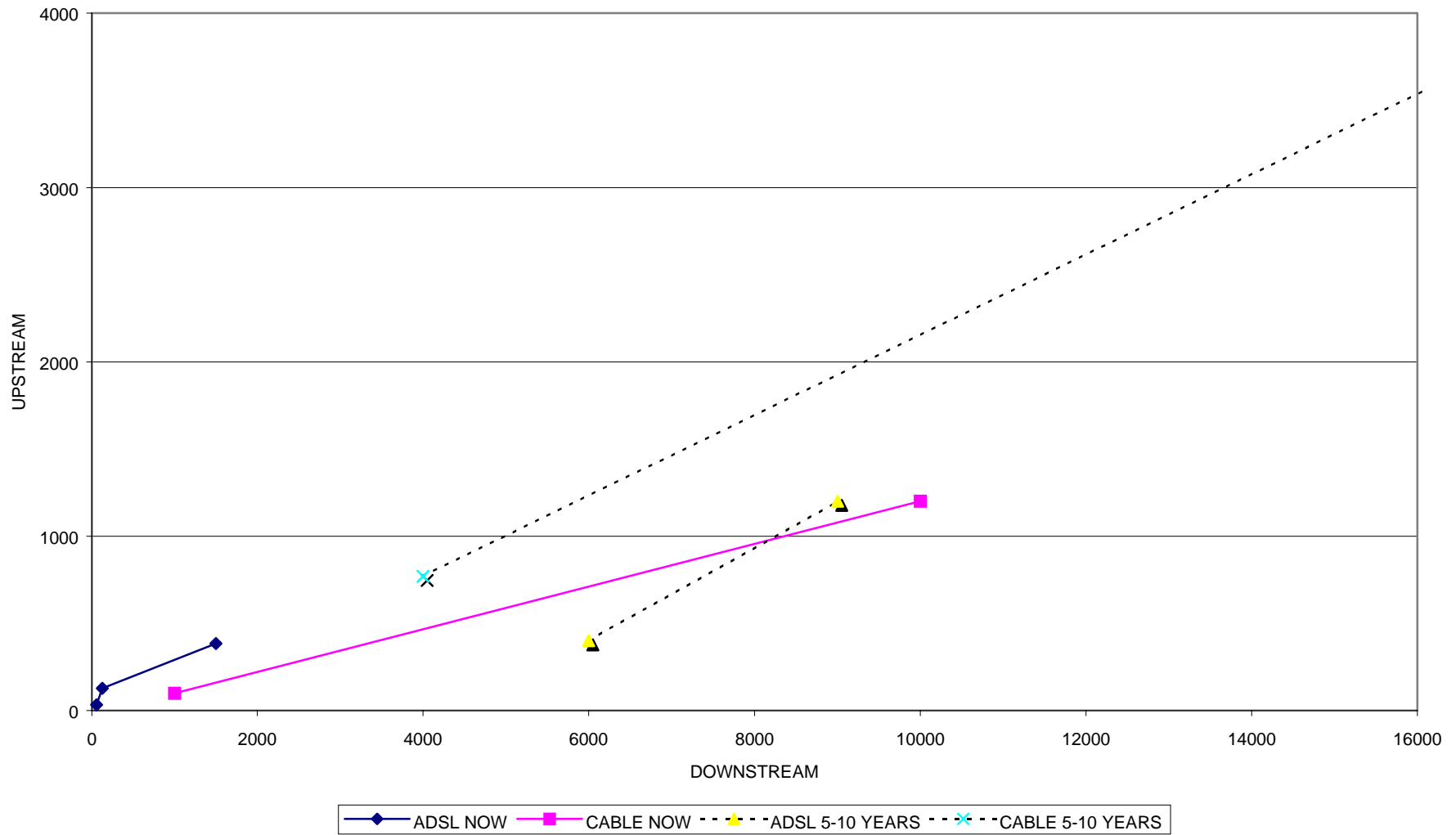
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Given the substantial head start that cable based Internet service enjoys in deployment and its superior and distinct technological capabilities, it is incorrect to include telephone-based xDSL as an alternative. It is certainly inappropriate to cite potential competition from an inferior competitor as a reason not to stop an otherwise anticompetitive merger. Even a strong advocate of ADSL is forced to admit that for the near to mid-term, the cable system is far superior in terms of speed (see Exhibit 12).¹⁰⁴ For the next five to ten years, DSL is deemed inadequate to provide video services.

¹⁰³ Nellist, John G. and Elliott M. Gilbert, *Understanding Modern Telecommunications and the Information Superhighway* (Norwood, MA, Artech House: 1999), pp. 137-1388... 147-148.

¹⁰⁴ The jacket blurb on Kim Maxwell says he "is the father of the modern dial-up modem and led the successful standards battle against AT&T and others for ADSL."

EXHIBIT 12:
 NEAR AND MID-TERM CAPABILITIES OF
 ADSL AND CABLE MODEMS
 (THOUSAND BITS PER SECOND, Kbps)



2. PROGRAMMING

The only two widely available Broadband Internet programming services – @Home and RoadRunner – are joined in the AT&T/MediaOne merger. In its financial disclosure statements @Home identifies Road Runner as the first source of competition for its service, the only one that is cable-based, and the only one that competes for both cable distribution arrangements and potentially end-user customers.

Providers of cable-based Internet services. For example, Time Warner Inc. and Media One Group have deployed high-speed Internet access services over their local cable networks through their own cable-based Internet service, Road runner. We currently compete with Road Runner to establish distribution arrangements with cable system operators, but may compete for subscribers in the future if and when our cable partners cease to be subject to our exclusivity obligations.¹⁰⁵

@Home describes itself as “the leading provider of broadband Internet services over cable television infrastructure to consumers.”¹⁰⁶ Its business model rests on exclusive arrangements with cable companies.

By virtue of our relationship with 21 cable companies in North America and Europe, we have access to approximately 65 million homes, which includes exclusive access to over 50% of the households in the United States and Canada... We have entered into distribution agreements with 18 cable companies in North America whose cable systems pass approximately 58.5 million homes.¹⁰⁷

Based upon the list of companies provided in the 10-Q report, we estimate that it has exclusive arrangements with companies that pass 53.4 million homes in the U.S. Not

¹⁰⁵ At Home Corporation, For 10-Q, May 17, 1999 (hereafter @Home 10-Q).

¹⁰⁶ @Home 10-Q.

¹⁰⁷ @Home 10-Q.

surprisingly, this includes the entire AT&T/TCI cable system. The additional cross-ownership with RoadRunner would have a dramatic effect on the market structure (as shown in Exhibit 13).

EXHIBIT 13
BROADBAND INTERNET MARKET CONCENTRATION

MARKET SHARE	CABLE-BASED BROADBAND		BROADBAND+ WIDEBAND	
	HOMES PASSED Millions	SUBS (%)	HOMES PASSED Million	SUBS (%)
@HOME 13 SYSTEMS	53.4	58	26.7	43
ROAD RUNNER		31	13.1	24
TIME WARNER	17.9			
MEDIA ONE	8.3			
HHI				
BEFORE	3754	4325	884	2425
AFTER	6724	7921	1584	4489

Subscribers all broadband = “The Battle for the Last Mile,” *The Economist*, May 1, 1999.

The cable-based broadband Internet market is currently highly concentrated, with an HHI based on the three firms of 3754. This assumes that Time Warner and MediaOne, the dominant joint venturers in Road Runner, claim exclusive rights to cable-based broadband Internet to their own subscribers. The merger would increase the market share by 3000 points. If the analysis is done on actual customers, it would reveal an even more dramatic

impact on the cable-based broadband Internet market. These two companies account for virtually all such subscribers, with @Home accounting for almost 90 percent of the market. This is a merger between a number one and a number two in a highly concentrated market.

Even if the current base of all cable-based and DSL customers is included, the two cable-based firms are dominant. The market remains highly concentrated as measured by actual subscribers and its concentration doubles as a result of the merger. The merger adds almost two thousand points to the HHI. The merger services account for about two-third of all subscribers.

Only by assuming that market share should be measured by counting each wire that passes each home, might we conclude that the current market is not highly concentrated. Suppose the base is doubled, by assuming two wires into the home. The HHI would fall to about 1500 before the merger.¹⁰⁸ However, the merger would be suspect because it doubles the concentration and drives it well into the highly concentrated range. The analysis based on all cable modem and xDSL subscribers leads to a similar conclusion. What this analysis really indicates is that the duopoly that customer would face in a two wire world should not be an acceptable outcome. As noted above, two rivals is not enough to make a competitive market.

If one examines the projections for the next year or two, one can argue that preventing the merger of the two leading cable-based broadband services would promote competition.

¹⁰⁸ For the purposes of this analysis assume 200 million wires (2 per home passed). Market shares are approximately as follows:

@Home=.267; SBC/Ameritech=.167; Bell Atlantic/GTE=.167; RoadRunner=.131; USWest=.08; Bellsouth=.08.

Cable-based modems are projected to control two-thirds or more of the broadband Internet market.¹⁰⁹ If one assumes that Road Runner would hold its market share or achieve a market share equal to its share of homes passed it would be significant player in the market. Therefore, the merger eliminated an important player and increases current and likely future concentration in the market.

This concentration in and vertical domination of the cable-based broadband market is striking. The avowed principles of exclusivity and bundling of access to broadband services with programming will dramatically lessen competitive entry into broadband Internet programming.

C. CONCERNS ABOUT THE ANTICOMPETITIVE EFFECTS OF VERTICAL INTEGRATION

We believe that the merger can be rejected on horizontal grounds in all three markets: cable systems, cable programming and broadband Internet. While the horizontal concentration problems that the merger poses are quite obvious in both the economic and regulatory dimensions, the vertical problems are more subtle but quite serious. Although the literature is generally more ambivalent about the impact of vertical integration, it is unequivocal where dominant firms merge in concentrated markets virtual integration through merger is likely to harm competition and hurt the public.

¹⁰⁹ Boersman, Matthew, "The Battle for Better Bandwidth – Should Cable Networks be Open?," *ZDNet*, July 11, 1999; Morgan Stanley Dean Witter, *The Digital Decade*, April 6, 1999.

When markets are concentrated and dominant firms are involved, the market structural conditions that allow firms to exercise of market power exist. Here it is important to note that the merger entails virtually all of the mechanisms of vertical dominance.¹¹⁰ In addition to direct ownership of some companies, the AT&T merger and related deals includes leasing of facilities, contracts and quasi-integration. Moreover, it embraces all three stages of the cable/Internet industry – production of programming (in both cable and Internet services), distribution (wires), and exhibition through control of equipment (set top box hardware and more importantly, software).

Given the complex nature of the merger and the market structure that would result, we believe that the appropriate description of what is happening is the creation of a digital conglomerate at the heart of a broadband cartel.

¹¹⁰ Perry, p. 186:

Vertical integration means the ownership and complete control over neighboring state of productions or distribution. In particular, a vertically integrated firm would have complete flexibility to make the investment, employment, and production and distribution decisions of all stages encompassed within the firm.

Leasing of capital can allow control of production without ownership.

Vertical “controls” characterize a vertical relationship between the two extremes of vertical integration and anonymous spot market exchanges. A vertical control arises from a contract between two firms at different stages, which transfers control of some, but not all, aspects of production or distribution.

Vertical “quasi-integration” is a term used to define financial relationships between firms in neighboring stages. These relationships need not involve additional control of productions and distribution decisions. Examples include equity investments, loans or loan guarantees, leases on real estate or capital, and inventory credits. Porter argues that these arrangements may create a community of interests, which can achieve some of the benefits of vertical integration

1. BARRIERS TO ENTRY

Vertical integration through merger can create barriers to entry. By integrating across stages of production, incumbents may force potential competitors to enter at both stages, making competition much less likely. These barriers take a variety of forms.

[V]ertical mergers may enhance barriers to entry into the primary industry if entrants must operate at both stages in order to be competitive with existing firms and if entry at both stages is substantially more difficult than entry at one stage.¹¹¹

A barrier to entry that receives considerable attention in the general literature is the need to raise large sums of capital for entry into vertically integrated industries.

Backward integration by a dominant manufacturer may also create a barrier to entry so as to preserve its dominance. Bain popularized the concept of barriers to entry and also discussed the importance of potential competition. Bain argued that vertical integration creates a capital barrier to entry by forcing potential entrant to contemplate entry at two stages of production rather than just one.¹¹²

To avoid these hazards, firms entering either of the markets in question might feel compelled to enter both, increasing the amount of capital investment required for entry. If, in addition, unit capital costs were higher with larger-scale entry attempts or if there were absolute barriers to raising the amount of capital needed for integrated entry, a chain of causation would run from vertical integration to increased risk of nonintegrated operation of the need for large-scale entry to capital cost barrier to entry.¹¹³

The emphasis on capital markets in the above discussions of barriers to entry is appropriate to this merger. The three dominant firms in the conglomerate – AT&T, Time

¹¹¹ Perry, p. 247.

¹¹² Perry, p. 197.

¹¹³ Scherer and Ross, p. 526.

Warner, and Microsoft ranked 7, 28 and 1 in terms of market valuation. Adding Time Warner to the count would push the total to almost three-quarters of a trillion dollars in capital. Other players in the cable TV and Broadband Internet markets come nowhere near this size. The largest programmer, Disney, ranks 34th, less than half the size of AT&T alone. No other cable operator comes even close.

Together, AT&T and Microsoft have a market value of more than half a trillion dollars and, if linked, would form the worlds leading force in technology and communications. Any AT&T-Microsoft partnership would be sure to arouse concerns among politicians and regulators. Though the two companies are not now competitors, both AT&T and Microsoft are behemoths with long traditions of dominating their industries. The prospect of an alliance is sure to seem mind boggling to at least some powerful people in Washington.¹¹⁴

The problem is not hypothetical. AT&T/@Home stress the fact that Internet Service Providers who want access to broadband technologies will have to make the investment in the transmission capacity.

Medin said if Prodigy and other ISPs don't like the current situation, instead of running to regulators for help, they should get behind DSL, or wireless or satellite access. Or, if they're so keen on cable, said Medin, they should string their own wires, or "overbuild" as it's called in the cable industry.¹¹⁵

Capital market barriers are only one of the problems that vertical integration and conglomeration can create to entry. Such mergers can also foreclose input markets to competitors.

¹¹⁴ Fabricant, Geraldine and Seth Schiesel, "AT&T Is Seen Forging Link to Microsoft," *New York Times*, May 7, 1999.

¹¹⁵ McWilliams Brian, "Prodigy Stumps for Access to Cable," *Internet News.com*, July 23, 1999.

When all production at a level of an industry is “in-house,” no market at all exists from which independent firms can buy inputs. If they face impediments or delays in setting up a new supplier, competition at their level will be reduced. The clearest form of this is the rise in capital a new entrant needs to set up at both levels.¹¹⁶

Ores, special locations, or other indispensable inputs may be held by the integrated firm and withheld from others. The integration prevents the inputs from being offered in a market, and so outsiders are excluded. A rational integrated firm might choose to sell them at a sufficiently high price.¹¹⁷

The focal point of concern about vertical integration in the cable industry has been the link between cable programming and cable systems. As noted, the major MSO’s involved in the AT&T deal are also the largest programmers. Concerns about this general pattern are heightened by AT&T’s consolidation of a cartel in programming as depicted in Exhibit 14.

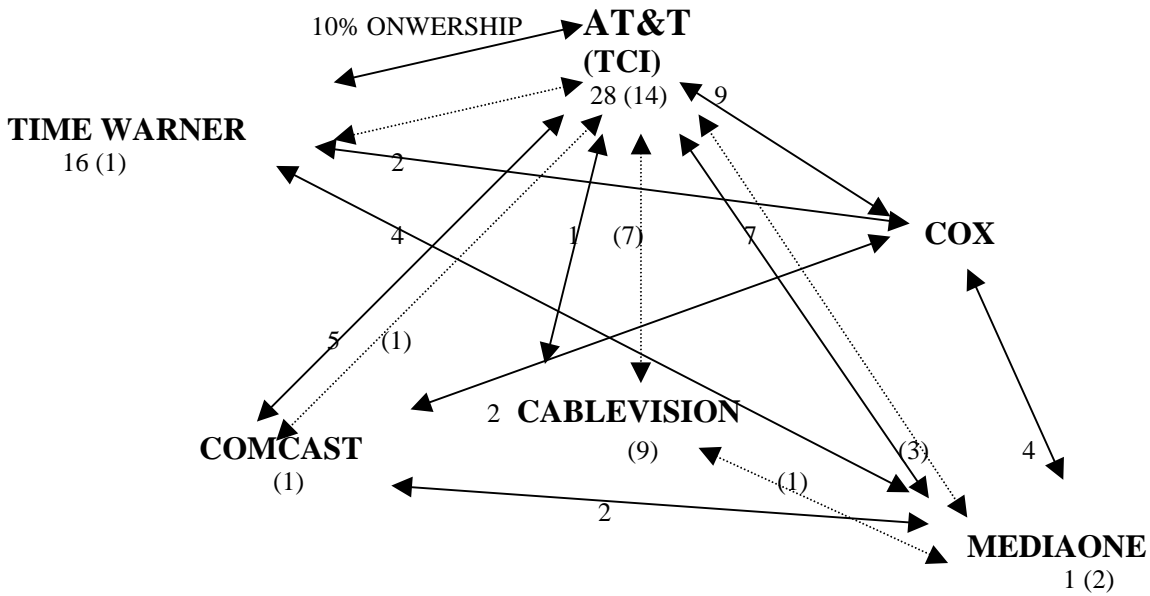
There is a long history of complaints about denial of access to subscribers by integrated MSOs and preferential access for affiliated programming. Evidence of these problems is both qualitative and quantitative.¹¹⁸ The dominant, integrated firms get the best deals,

¹¹⁶ Shepherd, pp. 289-290.

¹¹⁷ Shepherd, p. 290.

¹¹⁸ Ahn, Hoekyun and Barry r. Litman, “Vertical Integration and Consumer Welfare in the Cable Industry,” *Journal of Broadcasting and Electronic Media*, 41.

**EXHIBIT 14
HORIZONTAL CONCENTRATION AND VERTICAL INTEGRATION
OF CABLE TV PROGRAMMING**



Numbers in parentheses indicate regional programming
 Numbers not in parentheses indicate national programming
 Numbers under the company name indicate wholly owned programs
 Joint ventures in national programming are shown by \longleftrightarrow
 Joint ventures in regional programming are shown by $\cdots\longleftrightarrow$

SOURCES: Federal Communications Commission, In the Matter of Annual Assessment of the Status of Competition in Markets for the Delivery of Video Programming, CC Docket No. 98-102, Fifth Report, Table D-3, D-5.

One problem comes from most favored nation clauses that large operators often secure from programmers. Such clauses are supposed to guarantee an MSO of getting as good a price as any other operator, sometimes excluding Time Warner and TCI.¹¹⁹

Efforts to impose or obtain exclusive arrangements have become ever present controversies in the industry including efforts to prevent competing technologies from obtaining programming, as well as to prevent competition from developing within the cable industry.¹²⁰ Price discrimination against competitors and other strategies, such as placing programming of competitors at a disadvantageous position on the dial have also been evident in recent years.¹²¹

Allegations of anti-competitive cable practices are not limited to industry critics. The practices within the industry became so bad that even major players became involved in formal protests. Viacom and its affiliates, a group not interconnected significantly with the top two cabals in the industry, filed an antitrust lawsuit against the largest chain of affiliated

¹¹⁹ McAdams, John M. Higgins, "Hangover from Takeovers," *Broadcasting & Cable*, April 19, 1999.

¹²⁰ HBO, a subsidiary of Time, played a key role in the effort to prevent TVRO operators from obtaining programming (see Chan-Olmsted, op. cit., at 11), and the effort to sell overbuild insurance (Competitive Issues in the Cable Television on Industry, Subcommittee on Antitrust, Monopolies and Business Rights, Committee on the Judiciary, United States Congress, March 17, 1988, at 127, 152-174. The current efforts to impose exclusive arrangements have raised numerous complaints from potential competitors (see for example "Statement of William Reddersen on Behalf of Bell South Enterprises (hereafter, Bell South)," and "Testimony of Deborah L. Lenart on Behalf of Ameritech (hereafter, Ameritech)," Subcommittee on Telecommunications, Trade and Consumer Protection, Committee on Commerce, U.S. House of Representatives, July 29, 1997.

¹²¹ Competitive Issues in the Cable Television Industry, Subcommittee on Antitrust, Monopolies and Business Rights, Committee on the Judiciary, United States Congress, March 17, 1988. More recently, for example, The Time Warner, Turner merger as originally proposed included preferential treatment for TCI (see "Separate Statement of Chairman Pitofsky and Commissioners Steiger and Varney," In the Matter of Time Warner, File No. 961-0004. Efforts to exclude non-affiliated program have also been in evidence, as Viacom's most popular programming (MTV) has been bumped.

competitors in its New York territory. Ultimately, it sold its distribution business to its competitors.

The landscape of the cable industry is littered with examples of these anti-competitive behaviors. These include, for example, exclusive deals with independents that freeze out overbuilders,¹²² refusals to deal for programming due to loopholes in the law requiring non-discriminatory access to programming,¹²³ tying arrangements,¹²⁴ and denial of access to facilities.¹²⁵

Integration through this merger removes the leading cable broadband Internet service provider as a customer for broadband backbone transport. As @Home put it

On January 5, 1999, we announced that we had entered an agreement with AT&T to create a nationwide Internet Protocol network utilizing AT&T's backbone to cost-effectively support broadband service throughout North America over the next 20 years. This new backbone facility, which is scheduled to be deployed in mid-1999, represent a 100-fold increase in our backbone capacity and initially will enable use to support up to five million broadband users.¹²⁶

The merger and its associated deals also entail another structural characteristic that does not receive much attention in the merger-related vertical integration literature, but does

¹²² Bell South (p. 4)cites examples of suspected exclusive arrangements involving Eye on People, MSNBC, Viacom, and Fox, as does Ameritech (p. 7).

¹²³ The loophole will be terrestrial transmission to regional clusters, thereby avoiding the requirement to provide non-discriminatory access to satellite delivered programming. Bell South gives examples of Comcast in Philadelphia and Time Warner in Orlando (p. 5). Ameritech cites Cablevision in New York (p. 8). A similar process seems to be developing in Detroit (see).

¹²⁴ Bell South gives examples including NBC/CNBC, Scripps Howard/Home and Garden (p. 5).

¹²⁵ Testimony of Michael J. Mahoney on Behalf of C-TEC Corporation Subcommittee on Telecommunications, Trade and Consumer Protection, Committee on Commerce, U.S. House of Representatives, July 29, 1997.

¹²⁶ @Home 10-Q.

receive considerable attention in the general vertical restraint literature. As part of the transaction, AT&T has entered into a series of exclusive and preferential deals for the use of facilities and products. Given the size of the parties and the nature of the market, this can be anticompetitive.

The first firms to integrate into neighboring stages reduce the number of alternative sources for other firms at either stage. This “thinning” of the market can increase the costs of market or contractual exchange. Subsequent integration by other firms then becomes more likely.¹²⁷

Restrictions may be set on areas, prices or other dimension... Only when they are done by small-share firms may competition be increased. When done by leading firms with market shares above 20 percent, the restrictions do *reduce* competition.¹²⁸

Similarly, a dominant firm may also use vertical integration to raise the costs of its competitors... By leaving the open market thin, competitors may be unable to expand without significantly driving up the input price, they may be subject to higher prices set by the fewer remaining suppliers, or they may incur higher transaction costs for having to negotiate contracts with suppliers...¹²⁹

As previously noted, the AT&T-Microsoft deal on set top boxes is a major concern.

With Microsoft embroiled in a high profile antitrust case, its privileged position in the cable-based broadband market that would result from the deal has drawn fire. Not only does it dominate set top boxes, but it reduces potential competition for operating systems that could come from a broadband cable-based Internet industry.

As cable providers led by AT&T Corp. move aggressively to put increased computing power in television set-top boxes, the dominant computing platform

¹²⁷ Perry, p. 247.

¹²⁸ Shepherd, p. 294.

¹²⁹ Perry, p. 197.

of software giants Microsoft and its hardware partner Intel may fade in importance.

But with one sweeping deal, Microsoft has forged a wide-ranging alliance with the telecommunications leader that could leave it with a similarly dominant position in the emerging market for high-speed Internet and cable television services...

There are still some small-scale battles that have to be mopped up, but overall Microsoft looks like it has secured a pretty dominate position in this marketplace, both on the server and client side, said Scott McAdams. President of Seattle based brokerage McAdams, Wright Ragen. "I think it would be pretty hard for them to lose control going forward."

AT&T chairman C. Michael Armstrong himself drew the analogy between the part Microsoft plays in the personal computer industry and its role in the new generation of home entertainment and communications services.

"Just as Microsoft has published APIs (applications program interfaces) and had an open environment for their operating system, that will be true in the interactive TV arena of publishing APIs as well," he said.

That may be good news for software developers eager to create a new class of games, browsers and other programs that build on the new platform. But it is bad news for Microsoft's rivals and detractors who contend the Redmond, Wash.-based giant has abused its current monopoly position.¹³⁰

The irony of AT&T, which itself had been the target of a major antitrust action, citing Microsoft's routine business practices, which were the target of an even more high-profile antitrust case, is striking. But even without making assumptions about the business practices, the advantage gained could well be considered a threat to competition in the market.

AT&T seems to have agreed to make Microsoft's Windows CE the main (though not exclusive) operating system for the set-top box that cable subscribers will need to make their homes into multimedia centers, and to use other Microsoft software to offer customers email and Internet access through their televisions. Windows CE is somewhat clunky; but the alliance would

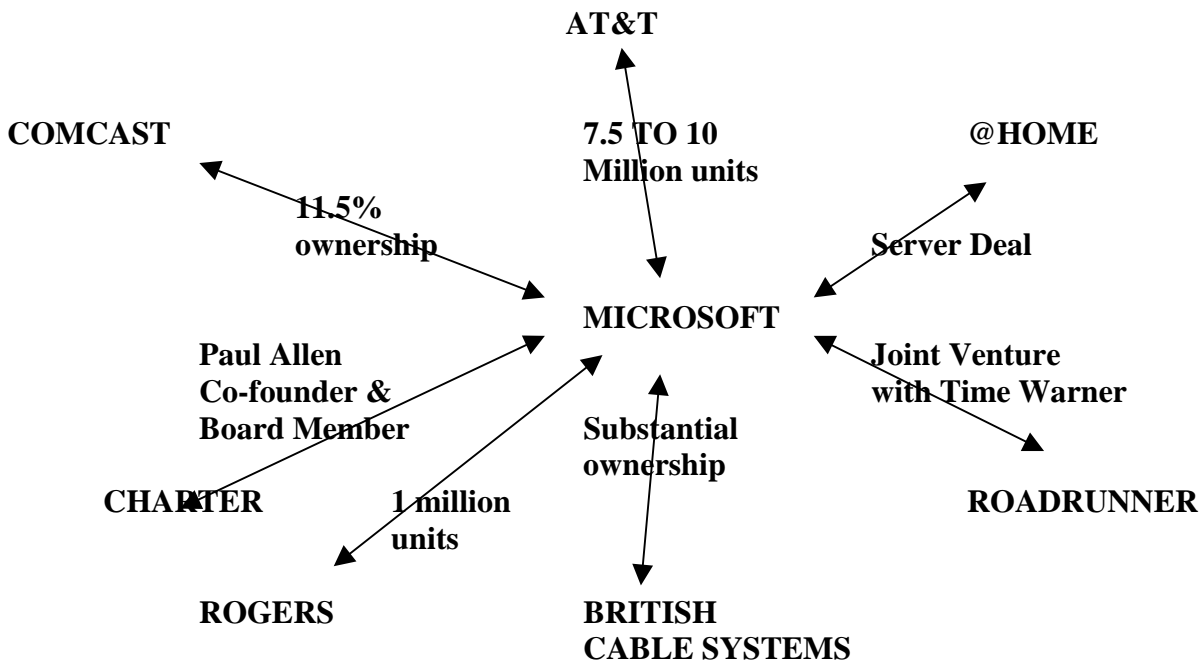
¹³⁰ Wolk, Martin, "Microsoft Poised for Major role in New Industry," *Reuters*, Seattle, May 6, 1999.

give Microsoft a first mover-mover advantage of the sort that Mr. Gates is good at exploiting.¹³¹

The Microsoft subplot in the deal involves more than the preferential access to as many as 10million of AT&T's set-top boxes (see Exhibit 15). Microsoft has forged separate

EXHIBIT 15
MICROSOFT'S LEVERAGE IN THE BROADBAND
INTERNET SET-TOP BOX MARKET

WITH A HISTORY OF EXCLUSIONARY PRACTICES AND A SERIES OF
PREFERENTIAL DEALS, MICROSOFT GAINS A FIRST MOVER ADVANTAGE
THAT WILL BE INSURMOUNTABLE



SOURCES: Cowell, Alan, "A Contest is On in Britain to Revolutionize Cable TV," *New York Times*, May 13, 1999; Boersma, Matthew, "Microsoft @Home Make Broadband Pact," *ZDNET*, May 13, 1999; Markhoff, John, "Microsoft Hunts Its Whale, the Digital Set-Top Box," *New York Times*, May 10, 1999.

¹³¹ "The Carve-up," *The Economist*, May 8, 1999.

links to cable systems with many millions more subscribers at Comcast, Charter, Rogers and several British cable companies, and has other links to the broadband service companies including a deal for the server side of the market with @Home.

Thus, the backbone market for the first five million subscribers and the set-top box market for the first 10 million subscribers served by the dominant cable-based Internet service firm has been foreclosed.

2. POTENTIAL COMPETITION

The merger and its related deals remove several of the most important potential entrants across a number of markets and stages of production.

Potential competition may be important for some markets. If one such potential entrant merges with a firm already inside the market, the ranks of actual plus potential competitors are reduced by one. Unless the entrant is in a vertical relation, the conglomerate reduces the total degree of competitive constraint, even if only slightly.¹³²

In addition, [Bain] pointed out that vertical merger also eliminated one of the most natural potential entrants into each stage. Indeed, these two theories are complements. It is difficult to argue that firms in neighboring stages are the most likely entrants without also believing that entry at both stages is more difficult than entry at one stage.¹³³

The obvious implication of the AT&T deals is that there are fewer competitors to enter each of these markets. Both AT&T and MediaOne should have been entering this market. As noted previously, AT&T had contemplated entry through new facilities, rather than the purchase of existing players.

¹³² Shepherd, p. 303.

¹³³ Perry, p. 197.

There is another aspect of the loss of potential competition in these industries. Because the cable industry has not been competitive, the possibility that broadband Internet services could compete against cable TV offerings is particularly important. Allowing cable TV companies to dominate broadband Internet undermines that possibility.

Not surprisingly one of the first steps taken by cable companies is to foreclose that possibility. Cable TV operators restrict the amount or duration of streaming video that consumers may receive over the broadband Internet. Unlike the relatively poor-quality streaming video over a common telephone modem connection, broadband-streaming video actually can give regular cable TV a run for the money. Unrestricted and open broadband Internet service could potentially compete against cable TV – by streaming full video programming to consumers. The private regulation of broadband access imposes restrictions to ensure that broadband Internet services will not undermine the cable TV monopoly.

AT&T's invokes the need to manage its network in response to the charges of discrimination and exclusion.

For this reason, concerns that have been raised about legitimate restrictions imposed on the @Home and RoadRunner services to limit video streaming applications are entirely misplaced. Cable Internet service actually *expand* the number of Internet applications available to consumers. Ancillary restrictions on the use of these services, which help manage bandwidth utilization, are entirely reasonable.¹³⁴

The Microsoft deal presents a similar cross-industry loss of potential competition. The vertical integration between AT&T and Microsoft allows it to capture a new market, which reinforces its hold on the PC operating system market.

¹³⁴ AT&T Filing, pp. 84-85.

3. CONDUCT

The market structural conditions that result from the concentration and integration of the industry make behavioral abuse effective. Cross subsidization becomes possible,¹³⁵ although this is by no means the only available instrument of anti-competitive conduct.

The simple concept involved in cross-subsidizing is that conglomerates can use profits from branch A to support deep, “unfair” price cuts by branch B...

If all branches of a diversified firm are dominant in their markets, their pooled resources are likely to increase their dominance through greater price discrimination, threats of punitive actions, and so forth. By contrast, a string of small-share branches is more likely to promote competition than to reduce it, if it can help its members at all.¹³⁶

The pricing patterns of the cable industry are a primary source of concern in this regard. The monopoly at the point of sale of video programming has allowed cable companies to impose sharp rate increases on the public. We will not repeat the heated debate over cable rates here. Suffice it to say that the increased consolidation in the industry and control over broadband access, which may compete with cable for provision of video programming reinforce the industry’s ability to impose price increases on cable subscribers.

Vertical integration facilitates price squeezes and enhances price discrimination.¹³⁷ Controlling the broadband bottleneck, cable firms can impose higher costs on their rivals, or degrade their quality of service to gain an advantage.

¹³⁵ Asch, Peter and Rosalind Senaca, *Government and the Marketplace* (Dryden Press, Chicago: 1985), p. 248.

Subsidization: The conglomerate firm can choose to behave in a predatory fashion in one market, subsidizing its predation from profits earned elsewhere.

¹³⁶ Shepherd, p. 302.

¹³⁷ Scherer and Ross, p. 524.

This could happen, if, for example, the conduct of vertically integrated firms increased risks for nonintegrated firms by exposing downstream specialists to regular or occasional price squeezes or made it difficult for upstream specialists to find market for their output in times of depressed demand.¹³⁸

The open access debate in Washington and at the local level centers on this discrimination issue. AT&T has fought vigorously to preserve the right to give its affiliated broadband Internet service provide an advantage. Consumers will have to pay twice for Internet access – once AT&T’s affiliate and a second time to any non-affiliated ISP the consumer wants.

AT&T also controls @Home Network Inc., the Internet service provider to which AT&T cable customers are forced to subscribe if they want high-speed data access via the cable lines. MediaOne is co-owner of a weaker cable-internet provider, RoadRunner, and its sage to assume that @Home will eventually the cable-Internet service provider for the MediaOne customers, too. Most likely, RoadRunner itself will become part of @Home before long.

AT&T and other cable companies understand the power of owning the first screen of digital information. It’s the front page to the digital world – an enormous asset in selling customers attention to advertisers and other companies.

So the cable companies are fighting bitterly to maintain that control, refusing to allow other Internet providers to gain the same kind of access to the cable lines that @Home now enjoys by default. Here’s an upgraded definition of two-way, cable-style: We’ll send you the Internet services – e-mail, home

Substitution elasticities of unity and less normally imply that inputs are indispensable, that is, that no output can be produced until at least some use is made of each relevant input. When the monopolist of an input indispensable in this sense integrates downstream, it can make life difficult for remaining downstream competitors. It can refuse to sell the input to them, driving them out of business. Or it can sell it to them at a monopoly price, meanwhile transferring input at marginal cost to its affiliated downstream units, which, with their lower costs, can set product prices at levels sufficiently low to squeeze the rivals out of the market

¹³⁸ Scherer and Ross, p. 526.

banking, etc. – that we designate, and you’ll send us a bigger check. If you want a different Internet service provider, fine – just send them a check too.¹³⁹

AT&T’s network management can clearly advantage its affiliated ISP.

Not only will the dominant firm in the industry gain the leverage to profitably engage in anti-competitive conduct, but also the dynamic processes in the industry will clearly shift toward cooperation and coordination rather than competition. The issue is not simply collusion, although that is a concern.

The *Guidelines* do recognize three major competitive problems of vertical mergers in concentrated industries. First, forward mergers into retailing may facilitate collusion at the manufacturing stage by making it easier to monitor prices or by eliminating a “disruptive buyer.”¹⁴⁰

Beyond collusion, a mutual forbearance and reciprocity, as spheres of influence are recognized and honored between and among the small number of interrelated entities in the industry.

Now we consider the big picture, rather than market-by-market effects. Imagine an extreme situation, which five big diversified firms extending into all major sectors. They coexist in parallel, touching one another in hundreds of markets. Whatever their effects on each market might be, they pose a larger problem of spheres of interest, or diplomatic behavior replacing competition...

Reciprocity is an exchange of favors. Reciprocal buying is one form of it. At its simplest, firm A buys from firm B because of some purchase that B makes from A...

Reciprocity: The large conglomerate may have numerous opportunities for reciprocal buying arrangements.

¹³⁹ Gillmor, Dan, “AT&T Deal Provides No Help to Consumer,” *Mercury Center*, May 5, 1999.

¹⁴⁰ Perry, p. 247.

Mutual forbearance: More generally (it is sometimes claimed) large firms treat each other with deference, avoiding competitive confrontation whenever possible.¹⁴¹

The final behavioral effect is to trigger a rush to integrate and concentrate. Being a small independent at any stage renders the company extremely vulnerable to a variety of attacks.

It is possible that business firms undertake vertical integration mergers not to enhance the level of monopoly power at some stage, but to redistribute it. Oligopolies often settle down into behavioral patterns in which price competition atrophies, even though some or all sellers suffer from excess capacity. Non-price rivalry then becomes crucial to the distribution of sales. One form of nonprice competition is the acquisition of downstream enterprises which, all else (such as prices) being equal, will purchase from their upstream affiliates. If acquisition of this sort deflects significant amounts of sales, disadvantaged rivals are apt to acquire other potential customers in self-defense, and reciprocal fear of foreclosure precipitates a bandwagon effect in which the remaining independent downstream enterprises are feverishly sought.¹⁴²

Triggering, If there are 10 nonintegrated firms and only one of them integrates, then little effect on competition might occur. But if this action induces the other 9 to do the same, the ultimate impact of the first “triggering” move may be large. Any increase in market power is magnified.¹⁴³

With the AT&T deal, the concentration and coordination in the industry has risen to an extremely high level. More can be expected.¹⁴⁴ In particular, as AT&T restructures to lower

¹⁴¹ Asch and Senaca, p. 248.

¹⁴² Scherer and Ross, pp. 526-527.

¹⁴³ Shepherd, p. 290.

¹⁴⁴ Colman Price and John M. Higgins, “More Deals to Come,” *Broadcasting & Cable*, March 29, 1999, identified seven of the top twenty-one markets, in which there were multiple cable systems. Of these, only one was consolidated directly by the AT&T-MediaOne deal.

its national share, it appears to be consolidating regional domination (and allowing others to do the same).¹⁴⁵

4. MONOPSONY POWER

One important aspect of the AT&T/MediaOne merger and related deals that has not been a major concern in the past is the issue of monopsony power. Monopsony is a situation in which “some buyer can perceptibly influence price.”¹⁴⁶

This topic is generally discussed under the broad category of vertical integration.¹⁴⁷ The issue is dealt with as an analysis of a large (or the sole) purchaser of an input or product at wholesale who can exercise bargaining power in the confrontation with suppliers who possess market power. The power of the buyer is said to countervail the power of the seller. This bilateral monopoly situation results in an improvement in consumer welfare under certain circumstances.

Under what circumstances might countervailing power lead to still better results for the consumer? The answer must involve an asymmetry on the buyer’s side: the buyer must be powerful enough to constrain the monopolistic seller’s prices, but lack the power as a reseller to charge monopoly prices.¹⁴⁸

¹⁴⁵ The list of metropolitan areas in More Deals indicates that at least two would be affected by the secondary deals associated with the merger.

¹⁴⁶ Scherer and Ross, p. 17.

¹⁴⁷ The major texts cited in this paper, Scherer and Ross, Shepherd and Perry all treat the issue in this context.

¹⁴⁸ Schere and Ross, p. 527.

The key to the outcome is “the absence or presence of power on the selling side of the market.”¹⁴⁹ Our concern is that the very large size of the post-merger AT&T will give it a great deal of monopsony power in the programming market. Since it faces little competition in the MVPD market, price concessions are not passed through. Moreover, price discrimination is likely.¹⁵⁰

5. OTHER NEGATIVE CONSEQUENCES

These are the negative effects of the merger strict economic terms. There are social and political concerns in the literature as well.

Loss of local control is one concern. This would be a particularly strong concern in a media industry.

There remain the social impacts of absentee ownership upon localities. Though they are less technically proven, they may ultimately be important.

One impact occurs through plant closures decided by distant officials who are unaware or insensitive about local strengths...

Local firms are normally knit into their communities, with the companies' officials contributing and participating in local affairs... When taken over by

¹⁴⁹ Schere and Ross, p. 532.

¹⁵⁰ Shepherd, p. 287, describes the situation as follows:

It is from the final level that pressure may arise to hold the bilateral monopoly to competitive results.

Bilateral oligopoly follows much the same lines as bilateral monopoly, ut of course the effects are not as sharp or clear. Powerful buyers will noe play off the sellerg against each other, extracting low input prices. Some will threaten to integrate vertically. The sellers, from their viewpoint, will be charging “what the traffic will bear,” in line with demand elasticities.

The whole process breeds price discrimination... The net tendency toward restricitve or competitive results will still depend on the oligopsonits' status as *sellers*.

large firms, the local companies typically stop their local involvement. Indeed, there is often a shift toward pressuring the city for tax reductions and other favors.¹⁵¹

A second concern is the accumulation of political power. Again, given the fact that this industry involves the most important means of information discourse this would be a particular concern.

Large size can also yield political power, for two main reasons. First, large firms are a focus of large-scale financial resources, which can be quickly mobilized and deployed effectively. Second, their large employment rolls give them a direct influence over voting patterns.¹⁵²

Supporters of conglomerate size limitations frequently respond to such claims with a “noneconomic” argument.. stating that the relevant issue for policy rests *not* in the “actual harms, however defined” that conglomerates create, but rather in “a *fundamental ideological concern* with giant aggregations of privately held assets.”¹⁵³

The joining of significant numbers of large corporations may well affect power in a broad context – visible perhaps in rising aggregate concentration measures – even though the impacts on specific markets cannot be readily discerned. This result may give rise to social or political rather than economic concerns, but even economists will concede that such worries are real ones.¹⁵⁴

¹⁵¹ Shepherd, p. 304.

¹⁵² Shepherd, p. 298.

¹⁵³ Asch and Senaca, p. 249.

¹⁵⁴ Asch, p. 264.